BUSINESS ENVIRONMENT

FRANCIS CHERUNILAM

Himalaya Publishing House

BUSINESS ENVIRONMENT

FRANCIS CHERUNILAM
M.A., M.B.A., D.D.P., Ph.D.
School of Management Studies,
Cochin University of Science and Technology,
Cochin — 682 022,
Kerala.

Seventh Revised Edition: 1996

For a variety in BOOKS
on all subjects
5 JUL 1997
Visit:
Vikas Books
Pacca Danga, JAMMU

HPH
Himalaya Publishing House
MUMBAI ● DELHI ● NAGPUR ● BANGALORE

First Edition : 1985
Seventh Revised Edition : 1996

Published by : Mrs. Meena Pandey
for **HIMALAYA PUBLISHING HOUSE,**
"Ramdoot", Dr. Bhalerao Marg, Girgaon,
Mumbai - 400 004.
Phones: 386 01 70 / 386 38 63

Branch Offices :

Delhi : "Pooja Apartments", 4-B, Murari Lal Street,
Ansari Road, Darya Ganj,
New Delhi - 110 002.
Phone: 327 03 92

Nagpur : Kundanlal Chandak Industrial Estate,
Ghat Road, Nagpur - 440 018.
Phones: 72 12 15 / 72 12 16

Bangalore : No. 24, 1st Stage, Gruhalaxmi Colony,
Hemavathi Road, Basaveswara Nagar,
Bangalore - 560 079 (Karnataka)
Phone: 332 25 56

Printed by : Globe Offset Printers,
New Delhi.

FOREWORD

Any serious thinking on contemporary and emerging issues of modern business suggests that the present assumptions and perspectives are increasingly becoming obsolete. Ethnic conflicts, energy scarcities, new ideologies and crazy dogmas are just a few of the characteristics that make the present quite different from the past. Further, they promise to make the future even more different from the present. In this context, the methods of historic discontinuties and trend-mutations render the conventional modes of decision-making counter-productive. What is required is a wide appreciation of the existing environmental factors and a vision of their evolution into the future.

It is no exaggeration to suggest a novel decision-culture where firm-level micro-decisions are shaped by national level macro-parameters. Building up such a culture involves a broad spectrum of considerations from the economic role of the government through the legal forms of business regulation to their social responsibilities. These are some of the requisites for equipping modern business to manage its affairs effectively.

Modern business is fixed in a complicated environment and in India it operates in a matrix of economic, political and legal framework with various levels of socio-cultural overtones. The development process superimposed leaves the foregoing factors in a state of flux. The adaptability of the firm level decision-making system to the external factors is contingent upon a thorough knowledge of the business environment.

In this book, Mr. Francis Cherunilam has attempted to describe the business environment particularly in India on a wide canvas. The description falls broadly into the three basic portions of the spectrum of the business environment, namely, the economic environment, the political-legal environment and the international environment. It may be mentioned here that Mr. Francis Cherunilam is the author of the three books entitled INDUSTRIAL ECONOMICS, BUSINESS AND GOVERNMENT and INTERNATIONAL TRADE AND EXPORT MANAGEMENT relating to the three sectors of the business environment. In addition to integrating them in the present work, Mr. Francis Cherunilam has brought into the fold such tricky but vital issues as consumerism, multi-national corporations and MRTPC. This book will be useful particularly to students of management and administration and to the post-graduate students of economics, commerce and political science. Books on Indian business environment are rare if not conspicuous by their absence. The one on hand is a welcome addition to the subject.

N. SOMASEKHARA
Chairman
Department of Industrial Management
Indian Institute of Science
Bangalore-560 012.

PREFACE TO THE SEVENTH REVISED EDITION

This revised edition is characterised by updating of information and other modifications. The chapters on *Foreign Capital and Technology* and *Joint Ventures* have been reworked.

Five years have been completed since the economic liberalisation was ushered in India. It is time to review the development of the Indian industry under the liberalised regime. Hence, a new chapter entitled *Five Years of Industrial Liberalisation* has been added.

I would like to place on record my gratitude to Shri D. P. Pandey and the Himalaya Publishing House for the constant encouragement. Words fail in expressing my indebtedness to those who have offered constructive criticisms and suggestions.

Cochin, **Dr. Francis Cherunilam**

21st June, 1996

PREFACE TO THE FIRST EDITION

The modern business is placed in a very complex and intricate environment. The constraints and opportunities provided by the nature of the economy and the economic system, political and legal framework, social system, geographical and ecological conditions, demographic factors, etc., have profound impact on the business. The type of product to be manufactured and marketed, the marketing strategies to be employed, the way the business should be organised, the technology to be adopted etc., are all influenced by the environmental factors. For formulating appropriate business strategies, one should, therefore, have proper understanding of the business environment.

This book is a humble attempt to sketch the various important aspects of the business-environment interface. A major part of the work is devoted to deal with the socio-economic and political and legal environment of the business in India.

I am very grateful to Prof. N. Somasekhara, Chairman, Department of Industrial Management, Indian Institute of Science, Bangalore, who was kind enough to write a Foreword to this book. I would also like to record my gratitude to all those who helped me, in one way or other, in my endeavour. I must particularly thank Mr. D. P. Pandey and the Himalaya Publishing House for their constant encouragement.

It may be pointed out here that as the business environment changes quite frequently, any work on this subject can be hardly uptodate. In fact, when this book was in press, some modifications in Government policy have taken place. Some of these policy modifications are stated in the *Postscript* given at the end of the book.

Constructive criticisms and suggestions will be most welcome.

FRANCIS CHERUNILAM

CONTENTS

1. **Business Environment and Strategic Management** 1-34

Micro-environment; Macro-environment; Environmental Change; Techniques for Environmental Analysis; Strategic Management; Conclusion.

2. **The Emerging Scenario** 35-49

The Global Scenario — Political and Economic Environment; Global Economic Boom; National Strategies; Business Strategies.

The Indian Scenario — Economic and Competitive Environment; Demographic and Social Environment; The Rise of the Rural Market; Future Trends.

3. **Business and Society** 50-69

Changing Concept and Objectives of Business; Professionalisation; Business Ethics; Business and Culture; Technological Development and Social Change; Cultural Lag.

4. **Social Responsibility of Business** 70-78

Responsibility to Shareholders; Responsibility to Employees; Responsibility to Consumers; Responsibility to the Community; The Indian Situation; Social Audit.

5. **Consumer Rights, Consumerism and Business** 79-94

Consumer Rights; Exploitation of Consumers; Consumer Protection; Utility of Consumerism; Consumer Protection and Consumerism in India; Opportunity for Industry; Consumer Protection Act, 1986, Amendments.

6. **Economic Systems** 95-102

Capitalism; Socialism; Mixed Economy; The Mixed Economy of India.

7. **Economic Roles of Government** 103-115

Regulatory Role; Promotional Role: Entrepreneurial Role; Planning Role; Economic Roles of Government in India The Constitutional Environment; Expansion in State Intervention.

8. **Monetary and Fiscal Policies** 116-130

Monetary Policy — Measures of Money Stock; Monetary Policy and Money Supply; Instruments of Monetary Policy; Fiscal Policy — The Union Budget; State Budgets; Finances of the Union and States; The Finance Commission; Importance of the Budget.

9. **Industrial Policy** 131-145

The Industrial Policy Resolution of 1948; Industrial Policy Resolution 1956; Review of Industrial Licensing System; Policy Development in 1970s; Industrial Policy Statement 1980; Policy Liberalisation in the Eighties; The New Industrial Policy.

10. **IDRA and Industrial Licensing** 146-158

Coverage of the Act; Exemptions from the Act; Central Advisory Council and Development Councils; Regulation of Scheduled Industries; Power to Investigate; Exercise Control; Take-over, Management etc.; Power to Provide Relief to Certain Industrial Undertakings; Sale or Reconstruction; Price and Distribution Controls; Power of Inspection; Decision of Central Government Final in respect of Certain Matters.

Letter of Intent and Licence; Objectives of Licensing; Activities Requiring Licensing; Power to Revoke/Amend Licence; Exemptions from Licensing; The New Policy.

11. **Protection of Patents and Trade Marks** 159-165

Patents — Indian Patents Law and Uruguay Round

Trade Marks — Trade and Merchandise Marks Act.

12. Industrial Development Strategy and Growth under Indian Planning 166-177

Introduction; Capital Goods vs. Consumer Goods; Roles of Public and Private Sectors; Village and Small Industries; Comparative Cost Dynamics; Import Substitution and Export Contribution; Capacity Utilisation; Regional Disparities; An Evaluation.

13. Public, Private, Joint and Co-operative Sectors 178-223

Public Sector Objectives; Growth of Public Sector; The New Public Sector Policy; Organisation of Public Enterprises; Government and Parliamentary Control; Pricing Policy; Nationalisation; Private Sector; Joint Sector — Formation of Joint Sector Enterprises; Rationale of Joint Sector; Evolution of Government Policy; The Concept of National Sector.

Co-operative Sector — Processing and Industrial Co-operatives; Distribution and Marketing Co-operatives; Functional Co-operatives; Multipurpose Co-operatives; National Level Co-operative Federation; Problems Consultancy Services.

14. Privatisation 224-233

Expansion of Public Sector and its Defects; The Privatisation Reaction; Ways of Privatisation; Obstacles; Benefits of Privatisation; Privatisation in India.

15. Village, Small and Ancillary Industries 234-248

The VSI Sector; Importance; Development of VSIs under the Plans; Objectives; Promotional Measures; Khadi and Village Industries; Ancillary Industries; Drawbacks and Problems; The New Policy; VSI in the VIII Plan, New Package.

16. Industrial Sickness 249-271

Definition of Sick Units; Magnitude; Weak Units; Causes of Sickness; Government Policy; Sick Industrial Companies Act; Financial Institutions and Industrial

Sickness; Sick Small-Scale Units; Turnaround Management, Amendment of SICA.

17. **Concentration of Economic Power** 272-286

Meaning; Causes of Concentration; Monopoly; Consequences of Concentration; Concentration and Monopoly Power in India; Remedial Measures; Large Houses and Companies.

18. **MRTP Act** 287-301

Objectives; Amendments; MRTP Commission; Control of Monopolistic Trade Practices; Control of Restrictive Trade Practices; Control of Unfair Trade Practices.

Annexure 20.1 : Unfair Trade Practices.
Annexure 20.2 : Restrictive Trade Practices.
Subject to Registration under the MRTP Act.

19. **Company Law in India** 302-323

A Brief History of Company Law in India; Meaning of Company; Classification of Companies; Formation of Companies — Memorandum of Association; Articles of Association; Prospectus; Board of Directors; Inter-Corporate Investments; Protection of Investors and Creditors; Winding up of Companies; Company Law Administration.

20. **Price and Distribution Control** 324-338

Objectives of Price and Distribution Controls; Price Policy in India; Price Controls; Direct Controls; Administered Prices; Dual Pricing — Subsidisation; The Essential Commodities Act; Other Laws to Control Production, Distribution and Prices; The Public Distribution System.

21. **Commodity Exchange and its Regulation** 339-344

Commodity Exchange; Commodities Suitable for Trading in Commodity Exchange; Spot and Futures Trading; Regulation of the Commodity Exchange — The

Forward Contracts Regulation Act; The Forward Markets Commission.

22. Money and Capital Markets 345-356

Meaning of Money Market; Constituents of a Money Market; Functions of Money Market; The Indian Money Market; Capital Market — Nature and Constituents; Importance of Capital Market; Capital Market in India — Nature of the Indian Capital Market; Development of the Market; Recent Development; Capital Market Reforms.

23. Stock Exchange and its Regulation 357-383

Meaning; Importance and Functions; Dealings on Stock Exchange; Speculation on the Stock Exchange; Organisation of Stock Exchange in India; Regulation of Stock Exchange Securities Contracts (Regulation) Act, Listing of Securities, OTEC; SEBI; SEBI Guidelines for Capital Issues.

24. Industrial Finance 384-398

Short-term Finance; Medium-term Finance; Long-term Finance; Corporate Securities; Ownership Securities; Creditorship Securities; New Issues — Marketing of Securities; Underwriting of Securities; Internal Financial (Ploughing Back of Profits); Public Deposits.

25. Industrial Financial Institutions 399-420

IDBI; IFCI; ICICI; IRBI; SHCI; DFHI; SFCs; SIDCs/SIICs Investment Institutions UTI; LIC; GIC.

Institutions for Small Industry — NSIC; SSIDCs; KVIC; SIDBI; Commercial Banks.

Appendix 28.1 : Leasing.

26. Labour Legislation 421-426

Principles of Labour Legislation; Labour Legislation in India — Laws Relating to Weaker Sections; Laws Relating to Specific Industries; Laws Relating to Specific

Matters; Laws Relating to Trade Unions and Industrial Relations.

27. **Labour Welfare and Social Security** 427-440

Introduction; Welfare and Amenities within the Precincts of the Establishment; Welfare Outside the Establishment; Social Security — Introduction; Legislative Enactments; Workmen's Compensation; Maternity Benefits; Employee's State Insurance; Provident Fund; Lay-off and Retrenchment Compensation; Family Pension; Gratuity Scheme.

28. **Industrial Relations** 441-456

Meaning; Industrial Disputes; Causes of Industrial Disputes; Industrial Disputes — Preventive Steps; Employer-Employee Relations; Tripartite Machinery; The Code of Discipline and Industrial True Resolution; Settlement of Disputes — Voluntary Arbitration; Machinery under the Industrial Disputes Act — Grievance Settlement Authority; Conciliation Officers; Boards of Conciliation; Courts of Inquiry; Labour Courts; Tribunals; National Tribunals; Reference and Awards; Prohibition of Strikes and Lock-outs; Other Important Provisions of the Act.

Annexure 28 .1: Schedules to Industrial Disputes Act.

29. **Worker's Participation in Management** 457-466

Meaning; Objectives; Problems and Limitations; Forms of Participation; Workers' Participation Schemes in India — Introduction; Works Committees/Joint Committees; Joint Management Councils; Shop/Department Councils and Joint Councils.

30. **Quality Circles** 467-472

Origin and Development of QCs; Meaning and Nature of Q.Cs; Philosophy of Q.Cs; Conditions for Success of Q.Cs., Reasons for Failure of Q.Cs; Conclusion.

31. Trade Unions 473-483

Meaning; Functions of Trade Union; Social Responsibilities of Trade Unions; Trade Union Movement in India — Factors Contributing to Growth; Some Important Developments; Limitations and Problems of Trade Unionism in India; Regulation of Trade Unions — The Trade Unions Act — Definition of Trade Union; Registration of Unions; Rights and Liabilities of Registered Unions.

32. Exit Policy 484-490

Need for Exit Policy, VRS and Golden Handshake; NRF; Conclusion.

33. Planning in India 491-504

The Planning Machinery; State Plans; Formulation of the Plan; A Review of the Plans; The Seventh Plan.

34. Development of Backward Areas 505-519

Identification of Backward Areas; Industrial Dispersal Policy; New Policy; Non-Industrial Development Programmes; An Assessment.

35. State and Agriculture 520- 528

Expansion and Development of Inputs and Services; Agricultural Marketing; Agricultural Price Policy.

36. Globalisation 529-545

Why Go International; Internationalisation Strategies; Globalisation of Indian Business.

37. Foreign Capital and Technology 546-557

Role of Foreign Capital; Private Foreign Capital; Limitations and Dangers of Foreign Capital; Government Policy.

Appendix 37.1: Annexure III of Industrial Policy Statement, July 24, 1991.

38. Joint Ventures 559-561

Why Joint Ventures? Indian JVs Abroad; Guidelines for Indian Direct Investment Abroad.

39. Multinational Corporations 562-575

Definitions; Dominance of MNCs; Investment Pattern; Investment Motives; MNCs and International Trade; Benefits of MNCs; Demerits; Recent Trends; Perspective; Code of Conduct; Foreign Investment by Indian Companies; MNCs in Inida.

40. Regulation and Promotion of Foreign Trade 576-601

The Foreign Trade Development and Regulation Act, 1992; Export Import Policy; Related Measures; An Evaluation of the Exim Policy; Organisational set-up and Functions; Export Promotion; Incentives. Financial Assistance; Marketing Assistance; Production Assistance/Facilities; Export Processing Zones and 100% Export-oriented Units; State Trading; Import Substitution.

41. Five Years of Industrial Liberalisation 602-611

Salient Features and Implications of Liberalisation; Increase in Investment; Increase in Turnover; Improving Competitiveness and Internationalisation; Foreign Investment; Need for Proper Orientation.

1

Business Environment and Strategic Management

That the environmental factors have a profound impact on business is very well indicated by the fact that environmental analysis and diagnosis are among the first steps in the strategic management process. Business dynamics is, in fact, a dependent factor — it depends on, *inter alia,* the environmental dynamics. Hence the importance of environmental analysis and diagnosis.

Environmental analysis is defined as "the process by which strategists monitor the economic, governmental/legal, market/competitive, supplier/technological, geographic, and social settings to determine opportunities and threats to their firms."[1]

"Environmental diagnosis consists of managerial decisions made by analysing the significance of the data (opportunities and threats) of the environmental analysis."[2]

The definition of environmental analysis given above has been made in the context of the strategic management process for an existing firm. It is, however, quite obvious that environmental analysis is the cornerstone of new business opportunity analysis too.

Indeed, today a much more greater emphasis is given than in the past to the fact that environmental analysis is an essential prerequisite for strategic management decision-making. For instance, in his recent editions of *Marketing Management*, Philip Kotler, the world renowned professor and author, describes *Marketing Environment Audit* as the first component of a *Marketing Audit*, whereas in the earlier editions of this book, the definition of Marketing Audit does not have any reference to the *environment*.

---

[1] William F. Glueck, *Business Policy and Strategic Management* (Auckland: McGraw-Hill International Book Co., 1980), p.88.

[2] *Ibid*. p.88.

It is now unquestionably accepted that the prospects of a business depend not only on its resources but also on the environment. An analysis of the strengths, weaknesses, opportunities and threats (SWOT) is very much essential for the business policy formulation.

Just as the life and success of an individual depend on his innate capability, including physiological factors, traits and skills, to cope with the environment, the survival and success of a business firm depend on its innate strength — the resources at its command, including physical resources, financial resources, skill and organisation — and its adaptability to the environment.

Every business enterprise, thus, consists of a set of internal factors and is confronted with a set of external factors.

The internal factors are generally regarded as *controllable factors* because the company has control over these factors; it can alter or modify such factors as its personnel, physical facilities, organisation and functional means, such as the marketing mix, to suit the environment.

The external factors, on the other hand, are, by and large, beyond the control of a company. The external or environmental factors such as the economic factors, socio-cultural factors, government and legal factors, demographic factors, geo-physical factors etc. are, therefore, generally regarded as uncontrollable factors.

As the environmental factors are beyond the control of a firm, its success will depend to a very large extent on its adaptability to the environment, i.e., its ability to properly design and adjust the internal (the controllable) variables to take advantage of the opportunities and to combat the threats in the environment.

The business environment comprises a micro environment and a macro environment.

MICRO ENVIRONMENT

"The micro environment consists of the actors in the company's immediate environment"[3] that affect the performance of the company. These include the suppliers, marketing intermediaries, competitors, customers and the publics. "The macroenvironment consists of the larger societal forces that affect all the actors in the company's micro environment — namely, the demographic, economic, natural, technological, political and cultural forces."[4]

---

[3] Philip Kotler, *Principles of Marketing* (New Delhi: Prentice Hall of India Pvt. Ltd., 1987), p. 124.

[4] *Ibid.*, p. 124.

It is quite obvious that the micro environmental factors are more intimately linked with the company than the macro factors. The micro forces need not necessarily affect all the firms in a particular industry in the same way. Some of the micro factors may be particular to a firm. For example, a firm which depends on a supplier may have a supplier environment which is entirely different from that of a firm whose supply source is different. When competing firms in an industry have the same micro elements, the relative success of the firms depends on their relative effectiveness in dealing with these elements.

Suppliers

An important force in the micro environment of a company is the suppliers, **i.e., those** who supply the inputs like raw materials and components to the company. The importance of reliable source/sources of supply to the smooth functioning of the business is obvious. Uncertainty regarding the supply or other supply constraints often compel companies to maintain high inventories causing cost increases. It has been pointed out that factories in India maintain indigenous stocks of 3-4 months and imported stocks of 9 months as against an average of a few hours to two weeks in Japan.[5]

Because of the sensitivity of the supply, many companies give high importance to vendor development. Vertical integration, where feasible, helps solve the supply problem.

It is very risky to depend on a single supplier because a strike, lock out or any other production problem with that supplier may seriously affect the company. Similarly, a change in the attitude or behaviour of the supplier may also affect the company. Hence, multiple sources of supply often help reduce such risks.

The supply management assumes more importance in a scarcity environment. "Company purchasing agents are learning how to "wine and dine" suppliers to obtain favourable treatment during periods of shortages. In other words, the purchasing department might have to "market" itself to suppliers".[6]

Customers

As it is often exhorted, the major task of a business is to create and sustain customers. A business exists only because of its customers. Monitoring the customer sensitivity is, therefore, a prerequisite for the business success.

---

[5] T.A.S. Balagopal, *Export Management* (Bombay: Himalaya Publishing House, 1986), p. 111.

[6] Philip Kotler, *Principles of Marketing*, *op.cit.*, p. 126.

A company may have different categories of consumers like individuals, households, industries and other commercial establishments, and government and other institutions. For example, the customers of a tyre company may include individual automobile owners, automobile manufacturers, public sector transport undertakings and other transport operators.

Depending on a single customer is often too risky because it may place the company in a poor bargaining position, apart from the risks of losing business consequent to the winding up of business by the customer or due to the customer's switching over to the competitors of the company.

The choice of the customer segments should be made by considering a number of factors including the relative profitability, dependability, stability of demand, growth prospects and the extent of competition.

Competitors

A firm's competitors include not only the other firms which market the same or similar products but also all those who compete for the discretionary income of the consumers. For example, the competition for a company's televisions may come not only from other T.V. manufacturers but also from two-wheelers, refrigerators, cooking ranges, stereo sets and so on and from firms offering savings and investment schemes like banks, Unit Trust of India, companies accepting public deposits or issuing shares or debentures etc. This competition among these products may be described as *desire competition* as the primary task here is to influence the basic desire of the consumer. Such desire competition is generally very high in countries characterised by limited disposable incomes and many unsatisfied desires (and, of course, with many alternatives for spending/investing the disposable income).

If the consumer decides to spend his discretionary income on recreation (or recreation cum education) he will still be confronted with a number of alternatives to choose from like T.V., stereo, two-in-one, three-in-one etc. The competition among such alternatives which satisfy a particular category of desire is called *generic competition*.

If the consumer decides to go in for a T.V., the next question is which form of the T.V. — black and white or colour, with remote control or without it etc. In other words, there is a *product form competition*. Finally the consumer encounters the *brand competition* i.e., the competition between the different brands of the same product form.

An implication of these different demands is that a marketer should strive to create primary and selective demand for his products.

Marketing Intermediaries

The immediate environment of a company may consist of a number of marketing intermediaries which are "firms that aid the company in promoting, selling and distributing its goods to final buyers".[7]

The marketing intermediaries include middlemen such as agents and merchants who "help the company find customers or close sales with them",[8] physical distribution firms which "assist the company in stocking and moving goods from their origin to their destination"[9] such as warehouses and transportation firms; marketing service agencies which "assist the company in targeting and promoting its products to the right markets"[10] such as advertising agencies, marketing research firms, media firms and consulting firms; and financial intermediaries which finance marketing activities and insure business risks.

Marketing intermediaries are vital links between the company and the final consumers. A dislocation or disturbance of this link, or a wrong choice of the link, may cost the company very heavily. Retail chemists and druggists in India once decided to boycott the products of a leading company on some issue such as poor retail margin. This move for collective boycott was, however, objected to by the MRTP Commission; but for this the company would, perhaps, have been in trouble.

Publics

A company may encounter certain publics in its environment. "A public is any group that has an actual or potential interest in or impact on an organisation's ability to achieve its interests".[11] Media publics, citizens action publics and local publics are some examples.

Some companies are seriously affected by such publics. For example, one of the leading companies in India was frequently under attack by the media public, particularly by a leading daily which was allegedly bent on bringing down the share prices of the company by tarnishing its image. Such exposures or campaigns by the media might even influence the government decisions affecting the company. Many companies are also affected by local publics. Environmental pollution is an issue often taken up by a number of local publics. Actions by local publics on this issue have caused some companies to suspend operations and/or take pollution abatement measures.

Growth of consumer publics is an important development affecting business.

---

[7] *Ibid.*, p. 126.

[8] *Ibid.*, p. 126.

[9] *Ibid.*, p. 127.

[10] *Ibid.*, p. 128.

[11] *Ibid.*, p. 130.

It is wrong to think that all publics are threats to business. Some of the actions of the publics may cause problems for companies. However, some publics are an opportunity for the business. Some businessmen, for example, regard consumerism as an opportunity for the business. The media public may be used to disseminate useful information. Similarly, fruitful cooperation between a company and the local publics may be established for the mutual benefit of the company and the local community.

MACRO ENVIRONMENT

As stated earlier, a company and the forces in its micro environment operate in a larger macro environment of forces that shape opportunities and pose threats to the company. The macro forces are, generally, more uncontrollable than the micro forces. A sketchy picture of the important macro environmental forces are given below.

Economic Environment

Economic conditions, economic policies and the economic system are the important external factors that constitute the economic environment of a business.

The economic conditions of a country – for example, the nature of the economy, the stage of development of the economy, economic resources, the level of income, the distribution of income and assets, etc.— are among the very important determinants of business strategies.

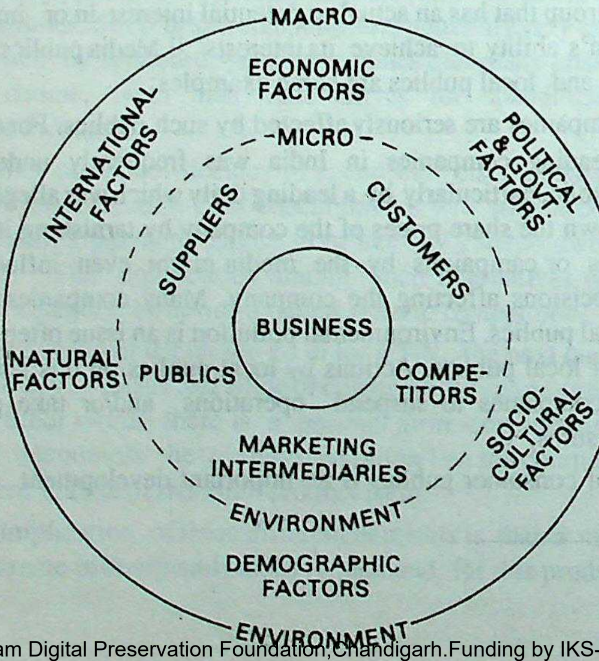

MACRO
ECONOMIC FACTORS
INTERNATIONAL FACTORS
POLITICAL & GOVT. FACTORS
MICRO
SUPPLIERS
CUSTOMERS
BUSINESS
NATURAL FACTORS
PUBLICS
COMPE-TITORS
SOCIO-CULTURAL FACTORS
MARKETING INTERMEDIARIES
ENVIRONMENT
DEMOGRAPHIC FACTORS
ENVIRONMENT

Fig. 1.1: Business Environment

In a developing country, the low income may be the reason for the very low demand for a product. The sale of a product for which the demand is income-elastic naturally increases with an increase in income. But a firm is unable to increase the purchasing power of the people to generate a higher demand for its product. Hence, it may have to reduce the price of the product to increase the sales. The reduction in the cost of production may have to be effected to facilitate price reduction. It may even be necessary to invent or develop a new low-cost product to suit the low income market. Thus, Colgate designed a simple, hand-driven, inexpensive ($10) washing machine for low-income buyers in less developed countries. Similarly, the National Cash Register Company took an innovative step backward by developing a crank-operated cash register that would sell at half the cost of a modern cash register and this was well received in a number of developing countries.

In countries where investment and income are steadily and rapidly rising, business prospects are generally bright, and further investments are encouraged. There are a number of economists and businessmen who feel that the developed countries are no longer worthwhile propositions for investment because these economies have reached more or less saturation levels in certain respects.

In developed economies, replacement demand accounts for a considerable part of the total demand for many consumer durables whereas the replacement demand is negligible in the developing economies.

The economic policy of the government, needless to say, has a very great impact on business. Some types or categories of business are favourably affected by government policy, some adversely affected, while it is neutral in respect of others. For example, a restrictive import policy, or a policy of protecting the home industries, may greatly help the import-competing industries, while a liberalisation of the import policy may create difficulties for such industries.

Similarly, an industry that falls within the priority sector in terms of the government policy may get a number of incentives and other positive support from the government, whereas those industries which are regarded as inessential may have the odds against them.

In India, the government's concern about the concentration of economic power restricted the role of the large industrial houses and foreign concerns to the core sector, the heavy investment sector, the export sector and backward regions.

The monetary and fiscal policies, by the incentives and disincentives they offer and by their neutrality, also affect the business in different ways.

An industrial undertaking may be able to take advantage of external economies by locating itself in a large city; but the Government of India's policy was to discourage industrial location in such places and constrain or persuade industries to go to the backward areas. From the point of view of an industrial undertaking, a backward area location may have many disadvantages. However, the incentives available for units located in these backward areas may compensate them for these disadvantages, at least to some extent.

According to the industrial policy of the Government of India until July 1991, the development of 17 of the most important industries were reserved for the state. In the development of another 12 major industries, the state was to play a dominant role. In the remaining industries, co-operative enterprises, joint sector enterprises and small-scale units were to get preferential treatment over large entrepreneurs in the private sector. The government policy, thus limited the scope of private business. However, the new policy ushered in since July 1991 has wide opened many of the industries for the private sector.

The scope of private business depends, to a large extent, on the economic system. At one end, there are the free market economies or capitalist economies, and at the other end are the centrally planned economies or communist countries. In between these two are the mixed economies. Within the mixed economic system itself, there are wide variations.

The freedom of private enterprise is the greatest in the free market economy, which is characterised by the following assumptions:[12]

(i) The factors of production (labour, land, capital) are privately owned, and production occurs at the initiative of the private enterprise.

(ii) Income is received in monetary form by the sale of services of the factors of production and from the profits of the private enterprise.

(iii) Members of the free market economy have freedom of choice in so far as consumption, occupation, savings and investment are concerned.

(iv) The free market economy is not planned, controlled or regulated by the government. The government satisfies community or collective wants, but does not compete with private firms; nor does it tell the people where to work or what to produce.

The completely free market economy, however, is an abstract system rather than a real one. Today, even the so-called market economies are subject to a number of government regulations. Countries like the United States, Japan, Australia, Canada and member countries of the EEC are regarded as market economies.

---

[12] George N. Halm, *Economic Systems — an adaptation* (New York: Peffer and Simons Inc., 1971), p. 15.

The communist countries have, by and large, a centrally planned economic system. Under the rule of a communist or authoritarian socialist government, the state owns all the means of production, determines the goals of production and controls the economy according to a central master plan. There is hardly any consumer sovereignty in a centrally planned economy, unlike in the free market economy. The consumption pattern in a centrally planned economy is dictated by the state.

China, East Germany Soviet Union, Czechoslovakia, Hungary, Poland, etc., had centrally planned economies. However, recently several of these countries have discarded communist system and have moved towards the market economy.

In between the capitalist system and the centrally planned system falls the system of the mixed economy, under which both the public and private sectors co-exist, as in India. The extent of state participation varies widely between the mixed economies. However, in many mixed economies, the strategic and other nationally very important industries are fully owned or dominated by the state.

The economic system, thus, is a very important determinant of the scope of private business. The economic system and policy are, therefore, a very important external constraint on business.

Political and Government Environment

Political and government environment has close relationship with the economic system and economic policy. For example, the communist countries had a centrally planned economic system. In most countries, apart from those laws that control investment and related matters, there are a number of laws that regulate the conduct of the business. These laws cover such matters as standards of product, packaging, promotion etc.

In many countries, with a view to protecting consumer interests, regulations have become stronger. Regulations to protect the purity of the environment and preserve the ecological balance have assumed great importance in many countries.

Some governments specify certain standards for the products (including packaging) to be marketed in the country; some even prohibit the marketing of certain products. In most nations, promotional activities are subject to various types of controls. Media advertising is not permitted in Libya. Several European countries restrain the use of children in commercial advertisements. In a number of countries, including India, the advertisement of alcoholic liquor is prohibited. Advertisements, including packaging, of cigarettes must carry the statutory warning that "cigarette smoking is injurious to health". Similarly, advertisements of baby food must necessarily inform the potential buyer that breast feeding is the best. In countries like Germany, product comparison advertisements and the use of superlatives like 'best' or 'excellent' in advertisements is not allowed. In the United States, the Federal Trade Commission is empowered to require a company to provide sufficient evidence to substantiate the claims concerning the quality, performance or comparative prices of its products. "What is being asked of the drug industry and of American business in general is a fuller disclosure of the relevant facts about products. For drugs, food additives, some cosmetic preparations, and so forth, a full disclosure requires more knowledge of the long-range side effects of materials ingested into the complex human body. For American industry as a whole, greater candour has been called for under such legislation as Truth in Lending and Fair Packaging Act, under administrative decrees such as the warning requirement on cigarette packages and advertising, under the threat of private damage suits using the common-law concept of warranty, and under voluntary programmes such as unit pricing and listing nutritional content of foods. The increasing complexity of products and the variety of product choices suggest further moves away from 'caveat emptor' or 'let the buyer beware' doctrines, moves which on the whole should prove a welcome although sometimes inconvenient challenge for business".[13]

There are a host of statutory controls on business in India. If the MRTP companies wanted to expand their business substantially, they had to convince the government that such expansion was in the public interest. Indeed, the "Government in India has an all-pervasive and predominantly restrictive influence over various aspects of business, e.g., industrial licensing which decides location, capacity and process; import licensing for machinery and materials; size and price of capital issue; loan finance; pricing; managerial remuneration; expansion plans; distribution restrictions and a host of other enactments. Therefore, a considerable part of the attention of a the Chief Eexcutive and his senior colleagues has to be devoted to a continuous dialogue with various government agencies to ensure growth and profitability within the framework of controls and restraints."[14]

Many countries today have laws to regulate competition in the public interest. Elimination of unfair competition and dilution of monopoly power are the important objectives of these regulations. In India, the monopolistic undertakings, dominant undertakings and large industrial houses are subject to a number of regulations which prevent the concentration of economic power to the common detriment. The MRTP Act also controls monopolistic,

---

13. Marshall R. Colberg *et al: Business Economies* (Homewood, Illinois: Richard D. Irwing Inc., 1975), p. 6.

14. T. Thomas, "Managing a Business in India" (Speech delivered by the Chairman, Hindustan Lever Ltd., at the Annual General Meeting of the Company held in Bombay on 20th February, 1980).

restrictive and unfair trade practices which are prejudicial to public interest. Such regulations brighten the prospects of small and new firms. They also increase the scope of some of the existing firms to venture into new areas of business. The special previleges available to the small scale sector have also contributed to the phenomenal success of the *Nirma*.

Certain changes in government policies such as the industrial policy, fiscal policy, tariff policy etc. may have profound impact on business. Some policy developments create opportunities as well as threats. In other words, a development which brightens the prospects of some enterprises may pose a threat to some others. For example, the industrial policy liberalisations in India, particularly around the mid-eighties have opened up new opportunities and threats. They have provided a lot of opportunities to a large number of enterprises to diversify and to make their product mix better. But they have also given rise to serious threat to many existing products by way of increased competition; many seller's markets have given way to buyer's markets. Even products which were seldom advertised have come to be promoted very heavily. This battle for the market has provided a splendid opportunity for the advertising industry. Advertising billing has been increasing substantially.

That an estimated cost savings of about Rs.200 crores per year have accrued to the Reliance Industries as a result of the changes in duties on some of the material inputs used by them is just an indication of the tremendous impact the fiscal and tariff policies can have on the business.

Socio-Cultural Environment

The socio-cultural fabric is an important environmental factor that should be analysed while formulating business strategies. The cost of ignoring the customs, traditions, taboos, tastes and preferences, etc., of a people could be very high.

The buying and consumption habits of the people, their language, beliefs and values, customs and traditions, tastes and preferences, education are all factors that affect business.

For a business to be successful, its strategy should be the one that is appropriate in the socio-cultural environment. The marketing mix will have to be so designed as best to suit the environmental characteristics of the market. In Thailand, Helene Curtis switched to black shampoo because Thai women felt that it made their hair look glossier. Nestle, a Swiss multinational company, today brews more than forty varieties of instant coffee to satisfy different national tastes.

Even when people of different cultures use the same basic product, the mode of consumption, conditions of use, purpose of use or the perceptions of the product attributes may vary so much so that the product attributes, method of presentation, positioning, or method of promoting the product may have to be varied to suit the characteristics of different markets. For example, the two most important foreign markets for Indian shrimp are the U.S. and Japan. The product attributes for the success of the product in these two markets differ. In the U.S. market, correct weight and bacteriological factors are more important rather than eye appeal, colour, uniformity of size and arrangement of the shrimp which are very important in Japan. Similarly, the mode of consumption of tuna, another seafood export from India, differs between the U.S. and European countries. Tuna fish sandwitches, an American favourite which accounts for about 80 per cent of American tuna consumption, have little appeal in high tuna consumption European countries where people eat it right from the can. A very interesting example is that of the Viks Vaporub, the popular pain balm, which is used as a mosquito repellant in some of the tropical areas.

The differences in language sometimes pose a serious problem, even necessitating a change in the brand name. Preett was, perhaps, a good brand name in India; but it did not suit in the overseas market; and hence it was appropriate to adopt 'Prestige' for the overseas markets. Chevrolet's brand name 'Nova' in Spanish means "it doesn't go". In Japanese, General Motors' "Body by Fisher" translates as "corpse by Fisher". In Japanese, again, 3M's slogan "sticks like crazy" translates as "sticks foolishly". In some languages, Pepsi-Cola's slogan "come alive" translates as "come out of the grave".

The values and beliefs associated with colour vary significantly between different cultures. Blue, considered feminine and warm in Holland, is regarded as masculine and cold in Sweden. Green is a favourite colour in the Muslim world; but in Malaysia, it is associated with illness. White indicates death and mourning in China and Korea; but in some countries, it expresses happiness and is the colour of the wedding dress of the bride. Red is a popular colour in the communist countries; but many African countries have a national distaste for red colour.

Social inertia and associated factors come in the way of the promotion of certain products, services or ideas. We come across such social stigmas in the marketing of family planning ideas, use of bio-gas for cooking, etc. In such circumstances, the success of marketing depends, to a very large extent, on the success in changing social attitudes or value systems.

There are also a number of demographic factors, such as the age and sex composition of population, family size, habitat, religion, etc., which influence the business.

While dealing with the social environment, we must also consider the social environment of the business which encompasses its social responsibility and the alertness or vigilance of the consumers and of society at large.

The societal environment has assumed great importance in recent years. As Barker observes, business "traditionally has been held responsible for quantities—for the supply of goods and jobs, for costs, prices, wages, hours of works, and for standards of living. Today, however, business is being asked to take on responsibility for the quality of life in our society. The expectation is that business—in addition to its traditional accountability for economic performance and results—will concern itself with the health of the society, that it will come up with the cures for the ills that currently beset us and, indeed, will find ways of anticipating and preventing future problems in these areas".[15]

As Stern succinctly points out, the "more educated the society becomes, the more interdependent it becomes, and the more discretionary the use of its resources, the more marketing will become enmeshed in social issues. Marketing personnel are at interface between company and society. In this position, they have the responsibility not merely for designing a competitive marketing strategy, but for sensitizing business to the social, as well as the product, demand of society".[16]

Demographic Environment

Demographic factors like the size, growth rate, age composition, sex composition, etc. of the population, family size, economic stratification of the population, educational levels, language, caste, religion etc. are all factors which are relevant to business.

Demographic factors such as size of the population, population growth rate, age composition, life expectancy, family size, spatial dispersal, occupational status, employment pattern etc. affect the demand for goods and services. Markets with growing population and income are growth markets. But the decline in the birth rates in countries like the United States have affected the demand for baby products. *Johnson and Johnson* have overcome this problem by repositioning their products like baby shampoo and baby soap, promoting them also to the adult segment, particularly to the females.

A rapidly increasing population indicates a growing demand for many products. High population growth rate also indicates an enormous increase in labour supply. When the Western countries experienced the industrial revolution, they had the problem of labour supply, for the population growth rate was comparatively low. Labour shortage and rising wages encouraged the growth of labour-saving technologies and automation. But most developing countries of today are experiencing a population explosion and a situation of labour surplus. The governments of developing countries, therefore, encourage labour intensive methods of production. Capital intensive methods, automation and even rationalisation are opposed by labour and many sociologists, politicians and economists in these countries. The population growth rate, thus, is an important environmental factor which affects business. Cheap labour and a growing market have encouraged many multinational corporations to invest in developing countries.

---

[15] R.F. Barker, "Are Profits and Social Concern Incompatible"? in *Pittsburgh Business Review*, August-September 1971 (cited in Louis E. Boone and David L. Kurtz, *Foundations of Marketing* (Hinsdale, Illinois: The Dryden Press, 1977), p. 43.

[16] Louis L. Stern, "Consumer Protection via Self-Regulation", in *Journal of Marketing*, July, 1971, p. 53.

The occupational and spatial mobilities of population have implications for business. If labour is easily mobile between different occupations and regions, its supply will be relatively smooth, and this will affect the wage rate.

If labour is highly heterogeneous in respect of language, caste and religion, ethnicity, etc., personnel management is likely to become a more complex task. The heterogeneous population with its varied tastes, preferences, beliefs, temperaments, etc. gives rise to differing demand patterns and calls for different marketing strategies.

References to a number of demographic factors that have business implications have already been made under "socio-cultural environment".

Natural Environment

Geographical and ecological factors, such as natural resource endowments, weather and climatic conditions, topographical factors, locational aspects in the global context, port facilities, etc., are all relevant to business.

Differences in geographical conditions between markets may sometimes call for changes in the marketing mix. Geographical and ecological factors also influence the location of certain industries. For example, industries with high *material index* tend to be located near the raw material sources. Climatic and weather conditions affect the location of certain industries like the cotton textile industry. Topographical factors may affect the demand pattern. For example, in hilly areas with a difficult terrain, jeeps may be in greater demand than cars.

Ecological factors have recently assumed great importance. The depletion of natural resources, environmental pollution and the disturbance of the ecological balance have caused great concern. Government policies aimed at the preservation of environmental purity and ecological balance, conservation of non-replenishable resources, etc., have resulted in additional responsibilities and problems for business, and some of these have the effect of increasing the cost of production and marketing. Externalities have become an important problem the business has to confront with.

Physical and Technological Environment

Physical Factors, such as geographical factors, weather and climatic conditions may call for modifications in the product, etc., to suit the environment because these environmental factors are uncontrollable. For example, Esso adapted its gasoline formulations to suit the weather conditions prevailing in different markets.

Business prospects depend also on the availability of certain physical facilities. Some products, like many consumer durables, have certain use facility characteristics. The sale of television sets, for example, is limited by the extent of the coverage of the telecasting. Similarly, the demand for refrigerators and other electrical appliances is affected by the extent of electrification and the reliability of power supply. The demand for LPG gas stoves is affected by the rate of growth of gas connections.

Technological factors sometimes pose problems. A firm which is unable to cope with the technological changes may not survive. Further, the differing technological environment of different markets or countries may call for product modifications. For example, many appliances and instruments in the U.S.A. are designed for 110 volts but this needs to be converted into 240 volts in countries which have that power system. Technological developments may increase the demand for some existing products. For example, voltage stabilisers help increase the sale of electrical appliances in markets characterised by frequent voltage fluctuations in power supply. However, the introduction of T.V.s, Fridges etc. with in-built voltage stabiliser adversely affects the demand for voltage stabilisers.

Advances in the technologies of food processing and preservation, packaging etc. have facilitated product improvements and introduction of new products and have considerably improved the marketability of products.

The television has added a new dimension to product promotion. The advent of TV and VCP/VCR has, however, adversely affected the cinema theatres.

The fast changes in technologies also create problems for enterprises as they render plants and products obsolete quickly. Product-market-technology matrix generally has a much shorter life today than in the past. It is particularly so in the international marketing context. It may be interesting to note that almost half of Hindustan Lever's 1980 export business did not exist in 1987. In fact, as much as a third of the company's 1987 turnover was from products and markets which were under three years of age.

International Environment

The international environment is very important from the point of view of certain categories of business. It is particularly important for industries directly depending on imports or exports and import-competing industries. For example, a recession in foreign markets, or the adoption of protectionist policies by foreign nations, may create difficulties for industries depending on exports. On the other hand, a boom in the export market or a relaxation of the protectionist policies may help the export-oriented industries. A liberalisation of imports may help some industries which use imported items, but may adversely affect import-competing industries.

It has been observed that major international developments have their spread effects on domestic business. The Great Depression in the United States sent its shock-waves to a number of other countries. Oil price hikes have seriously affected a number of economies. These hikes have increased the cost of production and the prices of certain products, such as fertilisers, synthetic fibres, etc. The high oil price has led to an increase in the demand for automobile models that economise energy consumption. The demand for natural fibers increased because of the oil crisis.

The oil crisis also prompted some companies to resort to demarketing. "Demarketing refers to the process of cutting consumer demand for a product back to level that can be supplied by the firm." Some oil companies — the Indian Oil Corporation, for example — have publicized tips on how to cut oil consumption.When the fertilizer price shot up following the oil crisis, some fertilizer companies appealed to the farmers to use fertilizers only for important and remunerative crops. The importance of natural manure like compost as a substitute for chemical fertilizers was aslo emphasised.

The oil crisis led to a reorientation of the Government of India's energy policy. Such developments affect the demand, consumption and investment pattern.

A good export market enables a firm to develop a more profitable product mix and to consolidate its position in the domestic market. Many companies now plan production capacities and investment taking into account also the foreign markets. Export marketing facilitates the attainment of optimum capacity utilisation; a company may be able to mitigate the effects of domestic recession by exporting. However, a company which depends on the export market to a considerable extent has also to face the impact of adverse developments in foreign markets.

Consumerism, Environmentalism and Societal Marketing Concept

Consumerism and Environmentalism have become two powerful social forces affecting business. Their growing importance increases the relevance of the *societal marketing concept*.

Consumerism is dealt with in detail in a subsequent chapter.

The recent *Earth Summit* was one of the reflections of the growing concern about the environment. Environmental issues have been affecting business fortunes and strategies for quite some time now. The phenominal rise of environmental awareness as seen in the U.S. and several other, particularly European, countries tend to make societal marketing concept the only relevant marketing philosophy.

The marketing concept was regarded as the appropriate strategy for a forward looking company and it was regarded socially quite acceptable because of its focus on the customer wants and satisfaction. It has, however, been now widely recognised that it has a serious drawback — it takes into account only the short-run customer satisfaction and company goals and it ignores the long-run societal interest. The short-run consumer satisfaction could be in conflict with the long-run consumer welfare or the social interests. For example, a product which gives short-run consumer satisfaction may have adverse effects in the long run. Similarly, the social costs of certain products while considering factors like the ecological factors may outweigh the short-run benefits to the consumers of the parents.

There are any number of examples of products whose short-term consumer benefits conflict with long-run consumer/societal welfare. Many products which have great appeal to the consumers have harmful effects on their health and life. Popular products in this category include cigarettes, pan masala, chinese foods like noodles containing monosodium glutamate (ajinomotto), artificial sweetners like aspartame, soft drinks containing barominated vegetable oil (BVO) and so on. Besides, there are products with high chances of accidents like certain types of polyurethane form used in furniture, bedding and mattresses which are highly inflamable, certain models of automobiles of certain companies and other dangerous products. Thirdly, there are products which cause ecological problems. There are three categories of such products. There are products the production of which causes environmental problem, secondly, there are products the production of which causes depletion of natural resources. Thirdly, there are products the consumption or use of which causes ecological problem. For example, it has been estimated that disposable diapers which account for 2 per cent of the solid waste stream in the U.S., cost about $ 300 million to dispose of. Throw away bottles, cans and other materials have, thus, made the affluent society an effluent society. In short, the short-term convenience gives rise to a long-term problem.

All these indicate that a socially responsible company must take into account the long-run consumer and societal welfare. As stated earlier, the drawback of the marketing concept is that it ignores the long-run welfare. It has, therefore, been felt that the marketing concept be revised incorporating the long run societal welfare. As Kotler observes, "the addition of long-run consumer welfare asks the businessman to include social and ecological considerations in his product and market planning. He is asked to do it not only to meet his social responsibilities but also because failure to do this may hurt his long-run interest as producer."[17]

There were many who regarded the societal marketing concept as utopian. There are still many who consider this concept as irrelevant, particularly in situations where a seller's market prevails. However, many companies have already adopted this concept and the developments in the advanced countries indicate that companies which want to be successful in future will invariably have to imbibe this philosophy.

What are the factors which make the societal marketing concept relevant? We can discren certain internal and environmental forces.

The internal forces are those internal drives of the organisation which lead to the adoption of this philosophy Business, like other social institutions, develops certain belief systems and values for which they stand, and these beliefs and values are a source of institutional drive. Egalitarian attitude and social orientation of the personnel, particularly of those at the helm of affairs, in the organisation will help it to imbibe the philosopy of the societal marketing concept.

It may be noted that there is a wide accpetance of the social responsibilities of the business. Organisations which whole-heartedly accept the social responsibility would not find it difficult to accept the societal marketing concept. Such developments emanate from the internal drives emerging from the belief and value systems guiding the organisational goals and performance. The Tata Iron and Steel Company which, in 1970, voluntarily incorporated in its Articles of Association its social and moral responsibilities to the consumers, employees, shareholders, society and the local people, is a shining example of a socially dedicated business enterprise. The Tisco fine tuned its social commitment by conducting a social audit, for the first time in the country, about a decade ago to examine and report whether, and the extent to which, the company has fulfilled its objectives contained in its Articles regarding the above responsibilities. In short, the adoption of the societal marketing concept is a natural corollary of the acceptance of the social responsibilities in real earnest.

There are certain environmental forces which drive comapnies towards adoting the marketing concept. These forces tend to make the survival of the companies otherwise difficult. Important among these forces are:

(i) growth of cosumerisms and environmentalism;
(ii) demand for social justice;
(iii) government regulations; and
(iv) changing competitive environment.

---

[17] Philip Kotler, "What Consumerism means to Marketers," *Harvard Business Review*, May-June, 1972.

CC-0 Agamnidhi Jammu. Digital Preservation Foundation,Chandigarh.Funding by IKS-MoE-2025-Grant

Consumer movement has become a powerful environmental force the business is confronted with. This is particularly so in the advanced countries where consumerism has made much headway. Consumer organisations test and expose the defects and adverse effects of various products. For example, the European consumer groups are said to have perfected the art of comparative testing. These groups systematically buy consumer products in markets and test them in laboratories. The results of such technical testing are then published in a form easily understood by consumers. Magazines carrying results of testing sell millions of copies to subscribers. These test results influence corporate sales and fortunes of business. Poor quality products are immediately exposed. Many European governments support these activities with financial grants while deficits are met by consumer subscriptions. The purpose of such comparative testing is to allow consumers to exercise informed choice on purchasing the best product at the lowest price.[18] The contribution of Ralf Nadar, the pionee of consumer movement, to consumerism in the U.S. and eventually in other parts is too well known to be described here.

Although consumer movemnt is not powerful in India, organisations like the Consumer Education and Research Society (CERS) and the Consumer Guidance Society of India (CGSI) are doing very commendable work. When consumerism gathers momentum, enterprises which are not socially responsive will find themselves in jeopardy.

A related development is the growth of environmentalism. In several countries there is a strong consumer preference for environmentally friendly products, i.e., products which do not pollute the environment or cause depletion of natural resouces, and many of these 'green consumers' are willing to pay extra money for such products. When Britain's fledgling *Green Party* won almost 15 per cent of the popular votes in the European parliamentary elections on the ticket of their concern for the environment most people were surprised. Following this analysts have come out with the prediction that environmental concerns are likely to trigger off big changes in consumer purchasing behaviour. According to a survey conducted by the London Agency Colman RSCG and Partners Ltd., 42 per cent of the British consumers said they chose their products because of their environmentally friendly packaging, content formulation or advertising.[19]

A number of companies have been swift to take advantage of this green revolution. Several polluting industries are in trouble. For example, the annual $ 3.5 billion disposable diaper market in the US, dominated by giants like Procter and Gamble and Kimberly Clark, is in jeopardy. The move against the ozone depleting chloroflurocarbons (CFCs), which are widely used in air conditioning, refrigeration, packaging and aerosols, has caused a lot of trouble for giants like Du Pont and Imperial Chemical Industries (ICI).

---

[18] Sri Ram Khanna and Voice Team, Comparative Testing of Consumer Products in Europe, *Consumer Confrontation*, January-February, 1989, p. 27.

[19] Deepa Arora, "A Clean Image", *A and M*, October 1989, p. 17.

The green wave is making many companies to take remedial measures for protecting environment. For example, big American companies, faced with the threat of tough new laws to make them cut their wastes, have been racing to show how well they can do the job voluntarily. Du Pont hoped to cut by 70 per cent, over a period of 2 years, the amount of hazardous waste produced by its factories. Monsanto announced that it would cut its air emission of hazardous chemicals by 90 per cent by the end of 1992, and its discharge of organic and toxic inorganic waste by 70 per cent by the end of 1995.[20] There is, indeed, big business in pollution control. It has been estimated that the global pollution control market will be worth $ 82 billion by end of the century.[21] Large investments are taking place for recycling waste paper, can, bottle and so on. McDonald's which produces hundred of millions of pounds of paper and plastic wastes annually, has become a crusading proponent of recycling and aims to become one of America's leading educators about environmental issues. Thus, as futurist Edith Weiner of the Manhattan management consulting firm Weiner Edrich Brown states, the smartest companies are not just facing this thunderous music they are singing along.[22] It has been observed that "in the nineties environmentalism will be the cutting edge of social reform and absolutely the most important issue for business."[23]

Tom Bruke of the Green Alliance in the U.K. observes that many companies are going green purely to capture a bigger share of the market. "If a company cannot increase profits by turnover of sales, it has to differentiate its product to garner a bigger market share and green is a good way of value-distinguishing one's products."[24]

Consumerism and environmentalism, thus, tend to drive companies towards the societal marketing concept. Government regulations add further thrust to this move.

Another social force to reckon with is the demand for social justice. A recent example is the campaign in foreign markets against Indian carpets alleging that the carpet industry in India thrives on ruthless exploitation of child labour. This sustained campaign launched by Swami Agnivesh has been reported to be the important reason for the remarkable slump in India's carpet exports in 1990-91. The campaigners have pleaded that the Western consumers must insist that the carpets they buy are free of child labour and a label must be fixed on each carpet certifying the same. Governments have been persuaded to take legislative measures prohibiting purchase of any commodity manufactured by child labour.

---

20. Cited by *The Economist*, September 2, 1989, p. 23.
21. Mathews K. George, " Seeing the Green Light", *South*, September 1989, p. 13.
22. Cited by G. Zacharias, R.K. Menon and S.K. Raja, "Marketing Challenges of the Nineties", *K-Man* (Quarterly Journal of Kerala Management Association), April-June, 1990.
23. *Ibid.*
24. Cited by Mathews K. George, *op. cit.*, p. 12.

A further impetus to societal marketing concept has been provided by increasing competition. When sellers' markets give way to buyers' markets, companies will be compelled to pay concerted attention to the consumer desires and attitudes.

Although the consumer and environmental movements are not powerful in India vis-a-vis the advanced countries, they are growing. So are the Government regulations. The competitive environment is also changing. Further, the foreign consumers also bother about the environmental effects of the imports in the producing countries. Governments are becoming increasingly concerned about the environmental impact of the production of their imports. For example, the U.S. law P.L. 101-162 prohibits the import of shrimp harvested with commercial fishing technology which may adversely affect the endangered or threatened sea turtles unless the President certifies the country has a turtle conservation programme comparable to that of the USA. The European Environmental Bureau has launched an appeal for a more serious consideration of environmental impacts when fisheries agreements are drawn up by the member states and other countries with third world countries.

In short, time has come in India too to take the societal marketing concept seriously. Prevention is better than cure and it will be in the interest of the business to accept this marketing philosophy voluntarily before it is thrust of them by the external forces.

There is a growing demand for products which economise resource use, environmentally and physiologically safe detergents, lead-free petrol, ozone friendly aerosols, toxic-free food items and so on. A socially responsible comapny will not wait for the government regulation to eliminate toxic elements from food preparations, will not market automobiles or any other product which do not satisfy safety requirements. The limits to growth and cost of growth have taken the world to such a situation that acceptance of the societal marketing concept, inter alia, is a must to maintain the ecological balance for the welfare of humanity.

ENVIRONMENTAL CHANGE

Business environment is dynamic. Many elements in the environment undergo changes. Technological changes are frequent. Tastes and the preferences of the people change. The competitive situation changes. Demographic factors, including population size, change. Attitudes and value systems undergo changes. Economic factors, like income, change continuously. Government policies and regulations also change to cope with the changing environment.

All these factors indicate that a business policy should be dynamic enough to be successfully adaptable to the changing environment. The success of a business depends on its ability to foresee the environmental changes and to modify its business strategies appropriately.

An exact prediction of the future events is, of course, very difficult. However, reasonably reliable forecasts are possible in many areas. For example, if the relevant data are available, it is possible to forecast the demand for a product. There are a number of forecasting techniques. An appropriate technique or techniques can be used, depending upon the characteristic features of the situation.

Similarly, forecasts can be made of such other factors as demographic factors, income levels, technology, etc. Such forecasts of the changes in business environment facilitate the formulation of appropriate business strategies.

TECHNIQUES FOR ENVIRONMENTAL ANALYSIS

Techniques for environmental analysis refer to the methods of gathering the relevant information for appraising the environment. Glueck mentions the following techniques for environmental analysis.[25]

(i) Verbal and written information

(ii) Search and scanning

(iii) Spying

(iv) Forecasting and formal studies

As these techniques are quite well known, we do not intend to explain them here.

STRATEGIC MANAGEMENT

An analysis of SWOT (i.e., strengths and weaknesses of the company and the opportunities and threats in the environment) plays a very important role in the strategic management process or the formulation of business policy.[26] A look at the strategic management process would make the importance of the external-internal factors nexus more clear.

Glueck defines strategy as a "unified, comprehensive and integrated plan relating the strategic advantages of the firm to the challenges of the environment. It is designed to ensure that the basic objectives of the enterprise are achieved."[27] Strategic management is defined as "that set of decisions and actions which leads to the development of an effective strategy or strategies to help achieve corporate objectives."[28]

Chandler describes strategic management as the determination of the basic long-term goals and objectives of an enterprise and the adoption of courses of action and allocation of resources necessary to carry out these goals".[29] According to Paine and Naumes, "Strategic management involves the decision-making and the activities in an organisation which (1) have wider ramifications, (2) have a long time perspective, and (3) use critical resources towards perceived opportunities or threats in a changing environment".[30]

---

[25] Willaim F. Glueck, *op. cit.*, p. 103.

[26] *Strategic Management* and *Business Policy* mean more or less the same. The term business policy was traditionally used to refer to what is today popularly described as strategic management.

[27] William F. Glueck, *op. cit.*, p. 9.

[28] *Ibid.*, p. 6.

Strategic management or business policy is the means to achieve the objectives. Strategic management process involves ascertaining the objectives, analysis of the environmental opportunities and threats and appraising the strengths and weaknesses of the firm to tap the opportunities or to combat the threats, formulating strategies to achieve the objectives on the basis of the SWOT analysis, choosing the most appropriate strategy, implementation of the strategy and reformulation of the objectives or strategy, if needed.

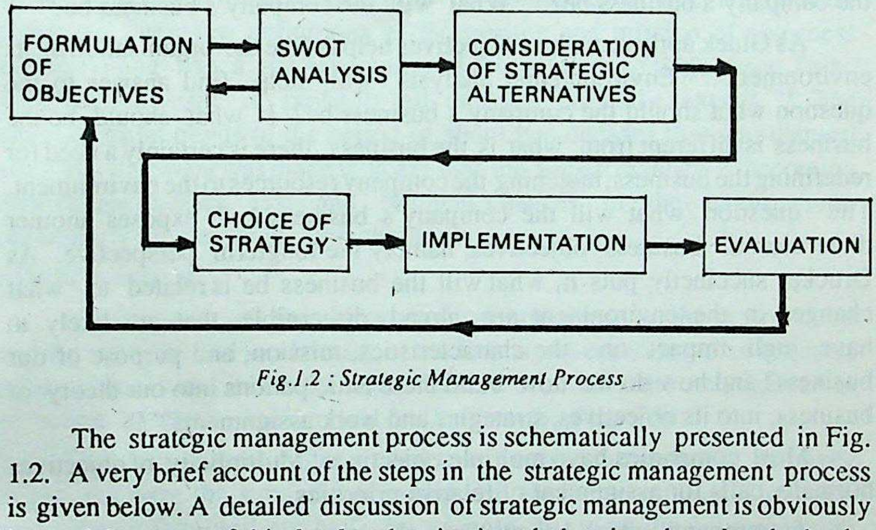

FORMULATION OF OBJECTIVES
SWOT ANALYSIS
CONSIDERATION OF STRATEGIC ALTERNATIVES
CHOICE OF STRATEGY
IMPLEMENTATION
EVALUATION

Fig.1.2 : Strategic Management Process

The strategic management process is schematically presented in Fig. 1.2. A very brief account of the steps in the strategic management process is given below. A detailed discussion of strategic management is obviously beyond the scope of this book; what is given below is only a sketch. As the objective of this chapter is to the highlight the importance of the environmental analysis to managerial decision-making, more space is devoted to the description of this step than the other steps.

Formulation of Objectives

Ascertaining/formulating the company objectives is the first step in the strategic management process. A strategy is, in fact, a means to achieve the ends or objectives. It should, however, be noted that objectives should not be static, they should be dynamic. That is changes in the environment and/or changes in the organisational strengths and weaknesses may call for modifications to the objectives. As Kotler remarks, "objectives can grow obsolete because of the continuous changes occurring in the company's marketing environment".[31] A company should therefore appraise how well its objectives tap the firm's opportunities and resources. Dynamic companies often conduct audit of their objectives and reformulate or reorient the objectives, if desirable, to ensure that the company's objectives are the most appropriate, given the environment and the company resources. It is such appraisal and the resultant reorientation of the business which have enabled many companies to achieve remarkable successes which are often reflected in the prudent diversification and fast growth of business.

---

[29] Alfred D. Chandler Jr., *Strategy and Structure: Chapters in the History of Industrial Enterprises*, p. 13 (Cited by Kenneth R. Andrews, *The Concept of Corporate Strategy* Bombay: Taraporevala Publishing Industries Pvt. Ltd., 1971).

[30] Frank T. Paine and William Naumes, *Organisational Strategy and Policy* (Chicago: The Dryden Press, 1982), P. 4.

To formulate clear objectives, it is essential to get definite answers to certain questions, viz., "what business the company is in?" "What should the company's business be?" "What will the company's business be?"

As Gluek aptly remarks, "objectives help define the organisation in its environment".[32] Environmental analysis will help find answer to the question what should the company's business be? If 'what should be the business' is different from 'what is the business', there is certainly a need for redefining the business, matching the company resources to the environment. The question 'what will the company's business be?' exposes another dimension of business objectives, namely the longterm perspective. As Drucker succinctly puts it, 'what will the business be' is related to "what changes in the environment are already discernible that are likely to have high impact on the characteristics, mission, and purpose of our business? and how do we now build these anticipations into our theory of business, into its objectives, strategies and work assignments?"[33]

Most companies have multiple objectives. Multiplicity of objectives normally calls for assignment of relative priorities.

A company which has multiple objectives normally pursue some objectives in the short-run and others in the long-run. A short-run objective may be a means to achieve a long-run objective. For example, the short-run objective of market penetration may be a strategy to help achieve the long-run objective of market dominance or profit. For instance, a key characteristic of the Japanese companies' strategy of entering the foreign

---

31. Philip Kotler, *Marketing Management* (New Delhi: Prentice Hall of India, 1974) p. 776.
32. *Ibid.*, p. 37.
33. Peter F. Drucker, *Management: Tasks, Responsibilities, Practices* (Bombay: Allied Publishers Pvt. Ltd., 1975) p. 89.

market "is to build up market share rather than early profits. The Japanese are patient capitalists who are willing to wait even a decade before realizing their profits."[34]

The following chapter of this book lists the primary and secondary objectives of one company. A company will normally pursue the secondary objectives listed therein as long-term objectives. This shall not be interpreted to mean that long-run objectives are secondary objectives. Some of the long-term objectives, like profit, are essentially primary objectives for most private enterprises. However, some of the long-term objectives of several companies, like development of the local community, assisting the development of the industry of which the firm is a part, serving the society, good corporate citizenship etc. are secondary objectives.

While the important long-term overall objectives may remain without significant change, modifications to or change of some of the objectives and the definition of the business (what business the company should be in?) may be necessitated by environmental factors. As Drucker points out, "very few definitions of the purpose and mission of a business have anything like a life expectancy of thirty, let alone fifty, years. To be good for ten years is probably all one can normally expect."[35] The environmental trends of the period of about two decades that has elapsed after this statement was made indicate that the life expectancy is becoming shorter due to very fast and frequent changes in the environment, particularly in the field of technology.

SWOT Analysis

Identification of the threats and opportunities in the environment and the strengths and weaknesses of the firm is the cornerstone of business policy formulation; it is these factors which determine the course/courses of action to ensure the survival and/or growth of the firm.

The environment might present many opportunities, but a company might not have the strengths to exploit all the opportunities. Similarly, sometimes a firm will not have the strength to meet the environmental threats. If a company, thus, finds that it will not have the competence to survive in a particular line of business, it will be prudent to give it up and concentrate on such business/businesses for which the firm is most competent.

The environmental dynamics many a time necessitates such restructuring. Wells has pointed out[36] that certain products which were exported in the early stages of the product life cycle by high income countries like the U.S.A. were later imported by them. Other countries which have acquired the technology would be able to produce them cheaper because of low labour cost or would sometimes improve the technology. Thus, although the U.S. had a very dominant position in electronic products and had been exporting them in the beginning, later countries like Japan started exporting them to the U.S. and replacing the U.S. in other markets too. An analysis of products traded by countries like Japan, Korea, Taiwan etc. would show the changes in the comparative advantages.

---

[34] Philip Kotler, *Principles of Marketing* (New Delhi, Prentice Hall of India Pvt. Ltd., 1987), p. 658.

[35] Peter F. Drucker, *op.cit.*, p. 89.

[36] L.T. Wells, "A Product Life Cycle for International Trade", *Journal of Marketing*, July 1968.

The environmental opportunities and threats should be evaluated in the light of the strengths and weaknesses of the internal factors comprising finance, technology and skill, production facilities, personnel and marketing capabilities. The capability of a company to exploit the environmental opportunities or to meet the challenges depends on the strength of these factors. Hence the importance of the internal resource audit. A company may be strong in respect of finance, technology, production facilities, personnel or marketing capabilities. The task is to make best use of its strategic strengths. For example, the strength of the *Reliance* in raising finance from the public was established. Hence, finance, a critical factor in a highly capital intensive sector, has not come in the way of the Reliance in tapping the fast growing markets for PVC, MEG and HDPE (As foreign technical collaboration is allowed in these areas of import substitution, acquisition of technology was not much of a problem). As the company was fully confident of easily mopping up about Rs.600 crores by the debenture issues, it did not seek to underwrite the issue and thereby saved about Rs.9 crores in underwriting commission alone.

For many companies, the primary strength is in the brand image/ company reputation and marketing. Several companies saw an opportunity in the premium segment of the toilet soap market in India which was growing at a very high rate of 35 per cent per annum as against the 15 per cent growth rate of the popular segment. The availability of large excess manufacturing capacities with firms like Godrej provided an opportunity for several market oriented companies to enter the market easily and with much less risk as they did not have to invest to set up production facilities.* Besides Hindustan Lever, Godrej, Tomco, Wipro, Karnataka Soaps and Detergents etc. which have their own production units, several established market oriented companies like Lakme, Ponds, Shaw Wallace, Richardson Hindustan, Reckitt and Coleman etc. with their strength in marketing and company/brand reputation, battled for a niche in the market.

---

* For example, Godrej Soaps manufactured Dettol for Reckitt and Coleman; Cleartone for Nicholas Laboratories; Johnson's Baby soap for Johnson and Johnson; and Pond's Dreamflower, Cold cream and Sandalwood for Ponds Ltd. besides manufacturing their own brands like Cinthol, Crowning Glory and Marvel.

The *Nirma* decided to take advantage of the brand popularity established by the washing powder and launched the detergent cake with the same strategy, *viz.*, low price and high promotion. The addition of the detergent cake gave a further boost to the surging sales of the company. The strength of the brand popularity has been further used to launch the Nirma toilet soap. Nirma sought to consolidate its industrial power by backward integration by establishing a Rs. 150 crore plant to produce linear alkyl benzene (Lab) and a Rs. 250 crore soda ash unit — both crucial raw materials for the detergent.

Realising the potential threat from the Nirma toilet soap, Godrej, Hindustan Lever and Tomco introduced popular brands to flank their positions. Godrej's market vigilence led to the introduction of the Vigil, the HLL introduced the Breeze and revived the Lifebuoy Personal and the Tomco came out with the Happy. Some of these products have become success in the market and it is doubtful whether the companies would have thought of them then but for the new competitive environment. Nirma's proposed new line, toothpaste, low priced as in the case of its other products, is expected to shake the position of the multinational Colgate-Palmolive.

Nirma benefited from the lower overheads and tax advantages of production in the small units. Hindustan Lever appears to have taken a clue from it; it has transferred substantial chunks of production to subsidiary and leased companies with lower overheads. It appears that the HLL introduced the low priced detergent 'Wheel' to fight the Nirma.

The case of Nirma is cited here to show how a small firm achieved miraculous growth and market success exploiting the environmental opportunities and how it has posed threats to the market giants compelling them to take several strategic decisions to combat the threat.

Monitoring of the environment is, thus, necessary to identify the emerging threats and to take measures to face them. When it was found that the motor cycle was eating into the share of the scooter in the two-wheeler market, Bajaj which had been concentrating on the scooter realised the emerging threat and decided to introduce a motor cycle so that what its scooters would lose might be gained by its motor cycle. Whether the new product is a success or not is a different issue; what is relevant here is the strategic decision.

Japanese companies saw an opportunity in the market segments for combact fuel efficient cars, small screen T.V.s' low horse power tractors etc. which were rather neglected by the American firms. As the Japanese firms were marketing these products in the home market, they were, unlike the American counterparts, comfortable with these products. The conjecture of the market opportunity and the strategic strength enabled the Japanese companies to penetrate the American market. After having consolidated their position in these segments, they have moved up to other segments with the strength of the reputation they established.

The general success of the Japanese in the world market is attributed to the right choice of the products and markets, based on a proper understanding of the environment and the internal strengths. Kotler and Fahey point out that "the Japanese government and companies work hard to identify attractive global markets. They favour industries that require high skills, high labour intensity and only small quantities of natural resources: candidates include consumer electronics, cameras, watches, motor cycles and pharmaceuticals. They prefer product markets that are in a state of technological evolution. They like product markets where consumers around the world would be willing to buy the same product designs. They look for industries where the market leaders are complacent or underfinanced".[37]

As mentioned in the section on objectives, a basic question to be answered while formulating the objectives is 'what business the company is in?' and environmental changes may call for a redefinition of the company's business. In this context, let us examine how the *Nelco* came out of the crisis it had been in for a long time.

Until the mid-1980s, the history of the Nelco (until 1969 known as the National Ekco Radio and Engineering Company Ltd.) read "like a saga of wrong decisions and missed opportunities" and it had been long written off as a chronic case.[38] After a brief sojourn in the sun between 1981 and 1984 (when it declared its only dividend in nearly two decades) this 'black sheep of the Tata group' which was notorious for its performance flip-flops, seemed to have slumped back to its normal apathy. The slump in 1984-85 provoked some serious soul searching and it raised the fundamental question: 'What business is Nelco in?' The strategists realised that the company would have to move from a substantial trading base to an in-depth manufacturing base. Earlier, Nelco had gone into a trading mode which means that the company gave its own manufacturing facilities and R and D a backseat and concentrated instead on hawking products made by small-scale units which, although provided short-term benefits, turned out to be a long-term disaster.

With the strategic decision to change the mode, the future objective has also been clearly defined: "We must be market leaders at the top end of the spectrum. Our products must be the best available and that is how we are going to project ourselves". In tune with this approach the company allied itself with various big names abroad like Mitsubishi and Mita of Japan, Honeywell-Bull of Italy, General Electric of the U.S. etc.

---

[37] Philip Kotler, *Principles of Marketing, op. cit.*, p. 658.

[38] This account of the Nelco is based on Parthasarathi Swami, "The Nelco Turn Around", *Business World*, April 11-24, 1988.

The T.V. Brands, 'Blue Diamond' and 'Zoom', Nelco introduced reflected its decision to concentrate on the upper market segment. The Zoom which allowed expansion of the image on the screen and which was priced at Rs. 14,420 was the costliest brand in the Indian market. Nelco had spent Rs. 2 lakhs on market research to identify the needs of the Indian consumers and the model was adapted accordingly so much so that 'when everyone was moaning and groaning about the competition in the market, the company did not find any problems' and was selling at the rate of about 1000 sets a months.

It may also be noted that the change in the Government environment and the resultant policy of broad banding made the reformulation of the product mix easier for Nelco; government agreed to broad band Nelco's radio receiver licence to T.V.s.

Another important aspect of Nelco's turn around management was the weeding out of the unprofitable products. The 'pots and pans' business, done under the brand name 'Kleerton', was sold off in 1978-80. This was followed by the dropping out of radio, calculator etc.

In short, establishing a proper nexus between the firm and its environment is necessary for business success.

Strategic Alternatives and Choice of Strategy

After the identification of the environmental opportunities and threats and the organisational strengths and weaknesses (and the reformulation of the objectives, if needed) the next tasks in the strategic management process are the consideration of strategic alternatives and the choice of the most appropriate strategy/strategies.

A company may be confronted with several alternatives such as:

(i) Should the company continue in the same business or get out of it completely or partly?

(ii) If it should continue in the same business, should it grow by expanding the existing units, establishing new units or by acquiring other units in the industry?

(iii) If it should diversify, should it diversify into related areas or unrelated areas?

(iv) Should it grow by vertical integration?

A company which plans to market its products in foreign markets may have the following alternatives:

(i) Manufacture the product completely in the home country and export it to the foreign market.

(ii) Establish manufacturing facility in a free area like an export processing zone and make exports from there.

(iii) Establish manufacturing facility in the foreign country and undertake the complete manufacturing of the product there.

(iv) Manufacture the components at home and assemble the product in the foreign market.

(v) Contract some foreign firm for manufacturing the product and do only the marketing of it.

(vi) Enter into licensing agreement with a firm in the foreign market.

(vii) Establish a joint venture abroad for manufacturing and marketing the product.

The choice of the strategy should invariably be based on the evaluation of the various alternatives.

Implementation

A good strategy is not a sufficient condition for success; its effective implementation is equally important. Many good strategies fail to achieve the results because of poor implementation. It is necessary to formulate a detailed plan to achieve the objectives by means of the chosen strategy. The term implementation is used in a broad sense so that it encompases also the formulation of the plan to implement the strategy.

In a multi-unit business, formulation of different levels of strategies is an essential and important aspect of implementation. There are three levels of strategies applicable to such a business.

(i) *Corporate Level Strategy:* This is the master strategy to achieve the overall corporate objectives. The other levels of strategies are designed to implement the corporate strategy and they are, therefore, formulated with reference to the corporate strategy.

(ii) *SBU Level Strategy:* It is the strategy to achieve the specific objectives of the strategic business unit (SBU) so as to help achieve the overall corporate objectives. A SBU is "an operating division of a firm which serves a distinct product/market segment or a well-defined set of customers or a geographic area. The SBU is given the authority to make its own strategic decisions within corporate guidelines as long as it meets corporate objectives".[39] The SBU is also known as 'operating division'.

(iii) *Functional Level Strategy:* The ultimate success of the SBU level strategy will depend, among other things, on the effectiveness with which it is translated to management functions like marketing, finance, production, R and D etc. For example, if some of the SBU level objectives are to be achieved by introducing a new product, the R and D, production, finance and marketing departments will have to be geared up to this task.

---

[39] William F. Glueck, *op.cit.*, p.8.

In a single unit business, there are, obviously only two levels of strategies, namely, the corporate level and the functional level.

The task of implementation involves mobilisation and deployment of resources, including personnel, needed for implementation, organising and assigning tasks to the various elements of the organisation. For effective implementation of the strategy it is essential to formulate an implementation strategy.

It may be pointed out that leadership implementation, restructuring the organisation and personnel motivation played their roles in the resurgence of the Nelco. Mr. S.K. Mukherjee who took over the reins of Nelco in 1986 was brought in after a long search, one of the rare instances in which the Tatas have inducted a top manager from outside their ranks.

Motivation and high morale of people from top to bottom of the organisation are essential for successful implementation of the strategy, besides their potential capability.

Evaluation

"Evaluation of strategy is that phase of the strategic management process in which the top managers determine whether their strategic choice as implemented is meeting the objectives of the enterprise".[40]

Failure to achieve the results may arise from any one or more of the following:

(i) Improper implementation of the strategy.

(ii) Environmental changes which were not anticipated while formulating the strategy.

(iii) Inappropriate strategy.

Improper implementation of the strategy may be due to:

(a) inappropriateness of the implementation strategy;

(b) inefficiency and/or lack of commitment of the personnel in charge of implementation;

(c) wrong assignment of the tasks; or

(d) inadequacy of resources.

Environmental changes such as increase in competition, changes in consumer preferences or attitudes, technological changes which could not be anticipated while formulating the strategy etc. may come in the way of achieving the results.

---

[40] William F. Glueck *op. cit.*, p. 348.

Sometimes environmental changes will make the achievement of the objectives easier. Such favourable changes in the environment which help achieve the objectives easily may sometimes even conceal the drawbacks of the strategy or its implementation.

The chances of environmental changes affecting the effectiveness or achievements of the strategy indicate the need for constant monitoring of the environment and modification or reformulation of the strategy, as and when necessary.

An inappropriate strategy may be the result of a wrong diagnosis (of the environmental threats and opportunities or the internal strengths and weaknesses) or of a wrong strategic choice resulting from the faulty evaluation of the alternatives.

In Fig 1.2, the loop connecting the evaluation to the beginning phase of the strategic management process indicates that strategic management is a continuous process, the evaluation providing the feedback for modifications.

Conclusion

The key to business success is the most effective utilisation of the company's resources (resources here mean not only the existing resources but also the additional resources it can mobilise and augment for any specific task). This involves the evaluation of the company's strengths and weaknesses in the light of the environmental threats and opportunities and taking appropriate measures to harness the opportunities or to combat the threats and formulation of strategies accordingly. Companies which fail to do so are often doomed to failure. Glueck points out that "in the 50 years between 1918 and 1968, almost half of the 100 largest American firms went out of business or became significantly less important ... Often a company becomes convinced it is almost invincible and need not examine what is happening in the market place. When the company ceases to adjust the environment to its strategy or does not react to the demands of the environment, by changing its strategy, the results are lessened achievement of the corporate objectives".[41]

Binny, which was once a 'great name in textiles' is not so conspicuous in the Indian market now, whereas the Reliance which is of comparatively recent origin is a force to be reckoned with today.

It may be relevant to mention here that two new business houses, Reliance and M.A. Chidambaram, are among the top 10 business houses of India today on the basis of assets. (In 1986 they had the 3rd and 9th places respectively.)

---

[41] *Ibid*, p 91.

Constant monitoring of the environment and timely and appropriate steps to tap the opportunities and to meet the challenges are essential for success. Environmental analysis will indicate the areas for diversification and growth as well as measures to face the problems. The Reliance has diversified into areas of import substitution and growing demand. The Telco has been constantly monitoring the commercial vehicles market has been taking measures to consolidate its position in the industry. Way back in the fifties, although Telco was the last manufacturer to enter the Medium and Heavy Commercial Vehicles scene, today it is the largest producer in this field in India and the company has been quite awake to the developments in the fast growing LCV sector. Similarly the Hindustan Lever has achieved significant growth and diversification within the Indian environment. There are many such success stories including those of small firms rising to dominant position, like the Nirma and the Jains of Jalgaon. On the other side are numerous failure stories.

In the international scene, the *Boeing* provides an example of how strategic management ensures business success. In early 1970s, the sales of the Boeing 737 began to tail off because of decline in orders from the airlines of developed countries like the U.S. Therefore, the company turned its attention to the underdeveloped countries, mainly the Middle East, Africa and South America. But it needed to adapt the plane to the idosyncrasis of the Third World aviation. The company redesigned the wings to allow shorter landings and added thrust to the engines for quicker takeoffs. It also redesigned the landing gear and installed low pressure tyres so that the plane would stick to the ground when it touched down. The gambit worked. The company sold one or two 737s at a time to airlines throughout the world compared to batches of 20 or 30 to the U.S. airlines in the past. As fledgling Third World airlines grew, they began buying Boeing's larger planes. Recently, the 737 became the best selling commercial jet in the history.[42]

An American Company, Texas Instruments, provides an example of failure due to negligence of the environmental factors and the subsequent success when adapted to the environment in Japan. The company which was making semi-conductors in Japan since 1961 took an American approach to hiring, pay and benefits, dissmissing the Japanese system of offering bonuses two times a year as impractical. The workers disagreed. Morale crumbled and the company had trouble recruiting employees. The company later adopted the Japanese methods of recruiting and reward including bonuses and a promotion system based strongly on seniority. These led the company to success and in 1985 it won the Deming prize for quality control, in Japan.[43]

---

[42] Andrew Kupfer, "How to be a Global Manager", *Fortune*, March 14, 1988, pp. 24-25.

[43] *Ibid*, p 27.

The Apple computers, which is very popular in the U.S., and the Colgate-Palmolive products failed in Japan as they were not adapted to the Japanese market. A study of 300 major American companies doing business in Japan has revealed that most of the successful companies entered the market with the strength of a resource driven product, a technological lead, a new to Japan concept, a differentiated marketing strategy or most likely, a combination of these.[44]

In short, proper response to the environment is a necessary condition for success. However, it should also be noted that there are many cases of failures resulting from hasty responses to environmental changes. In the wake of the industrial policy liberalisation in India, many entrepreneurs hastly obtained licences for diversification into several areas and this resulted in the issue of licences for production much more in excess of the demand for many products like television, two-wheelers, telecommunication items etc. A number of units started in this new flush found themselves in trouble and several of them gave up their licences. It appears that many entrepreneurs did not fully realise the threats unleashed by the liberalised industrial regime, namely the increased competition and the emergence of a buyer's market in place of a seller's market. This highlights the importance of forecasting in environmental analysis.

---

[44] Hideo Nakajima, "The Seven Cs: A recipe for foreign success in Japan", *Japan Economic Front*, April-June 1987.

2

The Emerging Scenario

The business environment is fast changing all over the world. This chapter takes a quick look at the important emerging trends across the world and in India.

THE GLOBAL SCENARIO

Political and Economic Environment*

Business environment, particularly the political and economic, has been fast changing all over the world. The Economic reforms which are being carried out in the erstwhile USSR, East European countries, Cuba etc. are so revolutionary that some years ago one could not even imagine such changes taking place in these countries. In the People's Republic of China, which had been following one of the most conservative policies, economic reforms began as early as the 1970s. Marketisation, privatisation and internationalisation have been progressing in these countries at an amazing speed. Several of these countries have effectively eliminated state monopoly of foreign trade and have drastically reduced import controls. There has been an influx of foreign private capital and technology. In short, the barrier of political ideology to business, particularly to international business is fast disappearing.

Far reaching reforms have been established in many non-communist countries too, particularly in developing ones. Economic liberalisation encompassing greater scope and freedom for private enterprise, both domestic and foreign, and trade liberalisation has been the centre point of these reforms. In countries like India, simplification of procedures and debureaucratisation have also been important.

---

* For a detailed account, see the author's *Economic Reforms in India and Abroad* (Himalaya Publishing House)

In several developed countries, there has been a further enlargement of the role of the private sector. The privatisation movement ushered in the United Kingdom by Margret Thatcher spread to other developed and developing countries, including the 'communist' ones, like a wave. In India, even in Kerala, where often populist political dogmatism dominated economic pragmatism, privatisation has been accepted by the Government as an important means of industrial and economic rejuvenation.

Privatisation has very significant socio-political significance which will add new dimensions to its economic implications. As the proportion of shareholders in the total population increases and as the economic lot of the workers and the poor improves, leftist parties increasingly lose their ground. In 1989, the Labour Party in Britain lost 8 per cent of its members. Between 1979 and 1989, the number of shareholders in Britain has almost trippled, from 7 to 20 per cent of the adult population. Interestingly, in 1988 Britain experienced a symbolic crossover. For the first time in history more British citizens were holders of shares than members of unions.[1] It is significant to note that it is for the first time that the Conservative Party was voted to power in Britain for the fourth consecutive period, the Labour party remaining out of power for such a long period. The membership of the trade unions in the U.K. has sunk by more than 25 per cent since 1979.

In short, the developments all over the world indicate growing economic internationalisation and privatisation.

Global Economic Boom

Naisbitt and Aburdene point out that in the decade of the 1990s the world is entering a period of economic prosperity. There is no single factor behind the economic boom, but instead an extraordinary confluence of factors. The economic forces of the world are surging across national boarders, resulting in more democracy, more freedom, more trade, more opportunity and greater prosperity.[2]

Although the problems of development, strategies of development, pattern of development and rates of growth may vary, all national economies are on the grow path, although there may be occasional set backs.

The recent developments in the centrally planned economies and other countries show that economic considerations ultimately transcend political considerations.

The growing population, the rising income and the new conducive policy environment will attract more investment into the developing countries. In the past, the major chunk of the investments by the MNCs went to the developed countries. Recent figures suggest that they are shifting emphasis to developing countries. In 1991, although the MNCs investments in the developing nations were still much lower than in the developed ones, there was an increase of 38 per cent in the MNCs' investments in the developing countries while there was a decline of 23 per cent in the developed countries.

---

[1] John Naisbitt and Patrica Aburdene, *Megatrends 2000* (New York, Avon Books, 1990) p. 198.

[2] *Ibid.*, p. 1.

The consumer boom will be most conspicuous in Asia, particularly in the Pacific Rim. At the same time, North America and Europe will face more competition from the Asian countries.

Naisbitt and Aburdene point out that Japan is moving from an export driven economy to a consumer-driven economy, a bellwether shift that other Asian countries will follow in the 1990. As the Asian economic miracle spreads throughout the Pacific, wage increases everywhere are creating millions of consumers.[3]

Asians will be the consumers of the 1990s. During the decade 80 million more will be added to the wealthiest Asian countries (Versus about 10 million in Europe). That means great opportunities for North American and Europeans, as well as for Asian producers.[4]

Several developing countries, however, will have to confront with certain very difficult problems. The AIDS menace is a grave problem. According to a recent report in the *Newsweek,* Asia lead by Thailand and India, would exceed Africa in HIV infections by 2000 A.D. Besides the social gravity of the problem, it is an economic menace too. The *Newsweek* reveals that according to a recent government sponsored study, unless the AIDS infection rate falls drastically, Thailand's GDP could be 10 to 20 per cent down in the next five years.

The problem in India too is very alarming. According to WHO forecast, 20 lakh Indians would be affected by AIDS by the turn of the century. It is rightly observed that India is sitting atop of silent volcano.

National Strategies*

Governments of different countries have been taking various measures to improve their economic competitiveness and to protect their other economic and noneconomic interests. Some of the important trends are outlined below.

Regional Economic Groupings: Regional economic arrangements for mutual benefits is not a new development. It has, however, become much popular recently.

The EC 92 is by far the most ambitious of such schemes. Although the Spanish people through the referendum of June 1992 rejected the Maastricht

---

[3] *Ibid.*, p. 11.

[4] *Ibid.*, p. 11.

* A more detailed account is available in the author's *Economic Reforms in India and Abroad.*

Treaty regarding the establishment of a monetary and economic union by 1 January, 1993, the development of the European Economic Community towards economic integration since the Treaty of Rome, 1957, has been considerable. Many companies from outside the Community have made strategic moves, including establishment of production bases within the Community, to overcome the European Fortress.

Several Free Trade Agreements have been in existence for quite some time now. However, some important new ones took birth recently and some more are likely to come into being. The North American Free Trade Agreement of 1988 between the U.S. and Canada was later extended to Mexico, making North America a giant free trade area. The Australia-New Zealand Closer Economic Relations Trade Agreement went into effect in 1988. The ASEAN has agreed to establish a free trade area by the year 2000. Surprisingly, there has also been talks about a US-Japan Free Trade accord. According to Naisbitt and Aburdene, as we turn to the next century, we will witness the link up of North America, Europe, and Japan to form a golden triangle of free trade. The big, powerful, overcharging megatrend is towards worldwide free trade, underneath which we witness the much weaker countertrends of protectionism.[5]

Protectionism: International trade is seriously affected by growing protectionism. While the GATT has made some achievements in reducing the tariff barriers, there has been a substantial growth of non-tariff barriers (NTBs), most of which are often referred to as the *new protectionism* measures. Such measures include voluntary export restraints and administered protection such as health and product standards, customs procedures, licensing etc. The developing countries, particularly, have been facing growing NTB to their exports to developed countries. According to a World Bank study, NTB in major industrial countries affect more than one-third of imports from developing countries, compared to one-fourth from all countries.

Several advanced countries like the USA who are high priests of free trade resort to several NTBs. The Super 301 and Special 301 of the U.S. Omnibus Trade and Competitiveness Act, 1988, have been used or have been threatened to be used to make other countries to fall in line with the U.S. policies or to restrict imports to the U.S. It has been reported that even Peoples' Republic of China liberalised the economic policies under their threat. Since the late 1970s, in the U.S. and E.C. protectionism has increasingly taken the *covert* shape. In these countries, there has been a growing demand for more protective measures in the wake of the challenge of their trade supremacy, particularly by the Pacific rim countries. Measures like the Super 301 may be used for covert protectionism like harassment of foreign rivals. First, the rivals may be accused of indulging in 'unfair trade' and then they may be taken through time consuming and expensive procedures. Japan, one of the major trade rivals of the U.S. and who has been constantly facing the threat of Super 301, has recently described the US as the biggest 'unfair trader' of the world. The developed countries have also been using their economic supremacy to compel the developing countries to accept the Dunkel Draft of the Uruguay Round of trade negotiations under the GATT, several provisions of which are very harmful to the interests of the developing countries.

---

[5] John Naisbitt and Patrica Aburdene, *op.cit.*, p. 5.

Because of the protectionist tendencies and other reasons, a number of manufacturers have established production facilities in foreign countries to substitute exports.

Government Support: Governments now not only support and encourage national industries in various ways but also foreign investments. Even the centrally planned economies are now luring multinationals. Government of many non-communist developing countries also have now a more positive attitude towards domestic private sector and foreign capital and technology. In America and Europe, although there is a resentment because of the expanding foreign ownership of the economy and increased competition to established industries, governments, several enterprises, and economists welcome foreign capital and technology because they bring the promise of jobs, tax revenues to cash-strapped local governments and help export and import substitution.

Business Strategies*

Some of the important strategic global business trends are given below:

Globalisation: The globalisation trend will become stronger. Many multinational corporations will transform themselves into global corporations. They will strive to enhance their competitiveness by tapping the scope for globalisation in sourcing, manufacturing and marketing. As Kotler observes, "many companies have become truly multinational organisations. They stop thinking of themselves as national marketers who venture abroad and start thinking themselves as global marketers. The top management and staff are involved in the planning of worldwide manufacturing facilities, marketing policies, financial flows and logistical systems. The global operating units report directly to the chief executive or executive committee, not to the head of an international division. Executives are trained in worldwide operations, not just domestic or international. Management is recruited from many countries; components and supplies are purchased where they can be obtained at the least cost; and investments are made where the anticipated returns are the greatest,"[6]

---

* A detailed account of the developments covered in this section is available in the author's book *Economic Reforms in India and Abroad*.

[6] Philip Kotler, *op.cit.*, pp. 674-75.

Domestic operations account for only a small part of the total revenue/profit of many multinationals. For example, Nestle, Europe's biggest food manufacturer which operates about 400 factories in almost all countries where private enterprise is possible, derives only two per cent of the total sales from its Swiss home market. In a truly multinational enterprise, not only that the sales revenue will be generated from many markets but also product development and other operations will be organised multinationally, as noted in the preceding paragraph. For example, Philip's first colour T.V. set was built and sold not in Europe where the parent company is located but in Canada where the market has closely followed the U.S. lead in introducing colour transmission; Philip's first stereo colour T.V. set was developed by the Australian subsidiary; teletext TV sets were created by its British subsidiary; smart cards by its French subsidiary; a programmed word processing typewriter by North American Philips — the list of local innovations and entrepreneurial initiatives in the company is endless. With only 8 per cent of the total sales coming from Holland, many different national subsidiaries of the company have contributed much larger share of total revenues than the parent company. As a result, foreign operations have enjoyed relatively high organisational status compared to most companies of similar size with headquarters in the US, Japan or even the larger companies in Europe.[7]

As Drucker points out, most people think of giant companies when they hear the word 'transnational'. But increasingly, medium and even small businesses operate in the world economy rather than in one or two countries. It is actually easier for the medium and even for the small company to operate without much regard for national boundaries. Unlike the large companies, they are politically barely visible.[8]

The renowed Harvard Professor Michael Porter in his latest book *The Competitive Advantage of Nations* points out that a global approach to strategy involves a number of elements. First, it clearly means selling worldwide, not just in the home market. However, international sales are viewed not as incremental business but as integral strategy. The firm builds an international brand name and establishes international marketing channels it controls. Second, a global strategy involves locating activities in other nations in order to capture local advantages, offset particular disadvantages, or to facilitate local market penetration. Third and most importantly, a global strategy involves coordinating and integrating activities on a worldwide basis in order to gain economies of scale or learning, enjoy the benefits of a consistent brand reputation, and serve international buyers. Simply operating internationally does not equate to a global strategy unless this sort of

---

7. C.A. Bartlet and S. Ghoslal, "Organising for Worldwide Effectiveness: The Transnational Solution," *California Management Review*, Fall 1988, pp. 61-62.
8. Peter F. Drucker, *The New Realities* (London, Mandarin, 1990).

integration and cooperation takes place. Advantage drawn from the global network add to home based advantages and make them more sustainable. The scale from selling globally, for example, may allow a higher rate of R and D spending to take advantage of sophisticated home buyers and sellers.

Porter argues that a company must move toward a global strategy as soon as its resources and competitive position allow if it is competing in a global industry. A high domestic cost of capital, high domestic factor costs, and a strong currency are no excuse in global competition. Yet competing internationally is not a substitute for improvement and innovation at home.

Sourcing: A growing trend and an important aspect of globalisation is 'global sourcing', i.e., procuring the various raw materials, components etc., from the lowest cost source available anywhere in the world. As Tom Peters points out[9], high speed computers and communications technology make possible the arrangement of the most exotic financing in a dozen currencies in a matter of days and this facilitates such developments in manufacturing as global sourcing. The growth of multinational subcontracting is an obvious indication of the growth of global sourcing. An important corollary of the global sourcing is the deintegration and hollowing of firms, i.e., tasks which were routinely done inside most firms are now subcontracted to outsiders-small and large, domestic and foreign.

The world sourcing market is estimated at about $1 trillion, forming nearly a third of the total world exports. Many South-East Asian countries have taken advantage of the growing global sourcing, contributing significantly to their economic development and export earnings. However, India has almost been bypassed by these developments mostly because of the conservative policies and bureaucratic hurdles.

Joint Ventures: There have also been a substantial increase in the joint ventures of different types. The economic reforms in the centrally planned economies and policy liberalisations in other countries have given a tremendous boost to joint venturing.

Mergers and Acquisitions: There has been a spurt in the cross-border mergers and acquisition (M and As). Although diversification has been a strong motivation for M and As in respect of many companies, a number of other factors like technical, strategic and financial advantages, political reasons and the fear of growing protectionism have also been behind the M and As surge. Mergers and acquisitions provide certain specific advantage like instant access to markets and distribution network and access to new technology or patent right.

Strategic Alliance: A new wave of competitive strategy is sweeping across the international business horizon. Known by such names as *entente*, *strategic alliance*, *coalition*, etc.; this strategy seeks to enhance the long term competitive advantage of the firm by forming alliance with its competitors, existing or potential, in critical areas, instead of competing with each other.

---

[9] Tom Peters, *Thriving On Chaos* (London: Pan Books, 1989) p. 9.

Strategic alliances which enable companies to increase resource productivity and profitability by avoiding unnecessary fragmentation of resources and duplication of investment and effort are growing in popularity and are very conspicuous in such industries as pharmaceuticals, computer, nuclear, telematics etc. which are characterised by high fixed costs in R and D and manufacturing and/or high and fast changing technology.

Ohmae argues that in a changeable world of rapidly globalising markets and industries — a world of covering consumer tastes, rapidly spreading technology, escalating fixed costs and growing protectionism — alliance is an essential tool for serving customers. Globalisation mandates alliances and makes them absolutely essential to strategy.[10]

According to Jet Magsaysay,[11] as the business environment, both locally and internationally, becomes increasingly competitive, companies will have more reasons and will find more ways to form strategic alliances. As that happens, strategic alliances will not only be a logical alternative but a key to survival in business. Management experts predict that in the not-too-distant future, alliances will be a necessity not only for individual companies **but** also for orderly development of entire industries, and that companies in mature, slow-growth industries will increasingly look to strategic alliances for survival.

As indicated above, several areas of business — From R and D to Distribution — provide scope for alliance. Whether it is in R and D, manufacturing, or marketing, an important objective of the collaboration is to maximise marginal contribution to fixed cost. Thus, as Ohmae points out, in the pharmaceutical industry, where both ends of the business. System (R and D and distribution) represent unusually high fixed costs, (potential) competitors swap their products for distribution in the respective markets where they have well established distribution systems. Several such alliances exist between, in particular, Japanese and US pharmaceutical firms. Strategic alliance have become popular in many other industries too.

Strategic alliances which have been rapidly increasing, particularly in the international business, are not confined entirely to large firms. There are many alliances between small and large firms. As indicated earlier, several factors like high risks and costs of R and D, fast changes and complexities of technology and the resultant imbalance in the inhouse technical capabilities, high cost of marketing, the need to acquire complementary technology and skills, need to achieve economies of scale or cost effectiveness through other ways such as outside sourcing, need to overcome market entry barriers, etc. make alliance, instead of competition, the best competitive strategy.

---

[10] Kenichi Ohmae, "Global Logic of Strategic Alliance," *Harvard Business Review*, March-April, 1989.

[11] Jet Magsaysay, "Strategic Alliance: Why Compete? Collaborate", *World Executive's Digest*, October 1989, p. 34.

THE INDIAN SCENARIO

India is on the threshold of a business revolution favoured by political, economic, social and demographic factors. The World Bank has recently observed that India could be one of the world's most dynamic economies by the turn of the century.

Economic and Competitive Environment

On the economic front, it is likely that the growth rate will accelerate. The pattern of growth would not, perhaps, justify the cry for distributive justice. It will not, however, bypass the poor completely. Poor will benefit by the employment opportunities generated and the increase in the financial resources of the Government due to higher tax revenue.

The drastic changes introduced in the economic policy recently has significantly changed the environment for industry and commerce. The piecemeal policy changes introduced in the 1980s have been gradually changing the competitive situation in a number industries. A buyers' market has been gradually emerging in several industries where a sellers' market prevailed. To take one example, two wheeler firms which in the past enjoyed the benefits of fabulous funds brought in by long advance booking of the products, in the situation of the supply being far shorter than the demand, are now arranging credit facilities to push sales. Quite naturally, as the competition became a hard reality to live with, companies begin to pay considerable attention to product features, quality, cost and after sales service. A two wheeler company, which also enjoyed excess demand for its products in the past, was constrained close down, unable to survive the competition.

The new economic policy has unleashed a new wave of competitive forces, with the industrial licensing abolished for most of the industries, the MRTP restrictions eased very much, many of the industries reserved for the public sector in the past opened for the private sector now, and the policy towards foreign investment and technology very much liberalised. This new environment is both an opportunity and a threat. While it has opened up a new vista of opportunities for a growth and expansion; it is also a threat in that it increases competition — the protection which many firms enjoyed in the past from competition by the licence raj and other regulatory constraints has been shattered. The new environment in India is indeed a challenge for the firms to prove their mettle.

Critics of the new policy argue that it will lead to the dominance of the Indian economy by multinationals and large houses in India and to the ruin of the small firms. Some even argue that even the large industrial houses of

India will be strangled by the multinationals. These fears will be proved wrong provided the government properly plays its regulatory role. This submission is based on several factors.

Firstly, although most of the provisions of the MRTP Act pertaining to concentration of economic power are gone, it is still a powerful weapon to control monopolistic, restrictive and unfair trade practices. The Act also retains the power to defuse concentration of economic power to the common detriment. If needed, the Act can be made more useful by amendment. It may be noted that the advanced market economies have strong anti-trust legislations. A vigilant government can modify its policies and regulatory mechanism to deal with various developments.

Secondly, growth of large firms need not ruin small enterprises. Experiences of several advanced countries show that growth of large firms can support development of small enterprises in many areas. The growing trend of deintegration and sourcing, referred to earlier, strengthens this possibility.

Thirdly, there are several Indian cases which show that small firms can achieve spectacular growth, effectively competing with large firms, including multinational, in the same industry. This has been witnessed in different industries such as soaps and detergents, paints, soft drinks, drugs and pharmaceuticals, electronics etc.

Fourthly, small firms can thrive by carving out profitable niches by appropriate marketing strategies. It may be pointed out that some small Indian firms are doing very well in markets of advanced countries by effectively employing the niche marketing strategy. Niching is only one of the strategies open to small enterprises. In several cases, a small enterprise may have certain strategic advantages over the large ones.

Fifthly, small enterprises in India too can flourish by international collaborations. They should strive to seize the opportunities of international sourcing. They could also become players in the international market through strategic alliances and joint ventures involving either large, medium or small foreign firms.

Sixthly, small firms can also strengthen their domestic market position through infusion of modern technology, including foreign.

Seventhly, innovative small enterprises, particularly with patented invention have abundant opportunities in a growing economy.

Eighthly, the new policy which provides a better environment for the infusion of modern technology will help increase the competitiveness of the domestic industries and will also help increase exports.

Ninethly, although the liberalisation is much talked about, only selected industries, which are mostly in the high-tech and priority sectors, including those with foreign exchange earnings potential are open to liberal foreign investment and technology.

Tenthly, it is wrong to assume that all multinationals or foreign products will have a run-away success in India. It may be noted that several foreign brands have miserably failed in India. There are a number of cases of multinational giants tasting bitter failure in foreign markets. Procter and Gamble, for example, had a very bad time in Japan. P and G which entered the Japanese market in 1973 lost money until 1987. P and G has been facing a hard time in Poland where it entered recently.

It may be noted that price conscious consumers in many countries are increasingly turning to *no-brand goods*. No-brand goods are getting growing attention by department stores. Some of them have separate sections which sell only no-brand goods.

Eleventhly, it is wrong to assume that the multinational giants will cripple even the large industrial houses of India. The large houses of India are, of course, very very small in size compared to the multinational giants. Largeness certainly is a strength in several respects. The policy environment in India had come in the way of growth of large houses. Their strength to compete in the international market would have been better now had their resource positions been better. Despite such limitations, several large Indian companies are poised for a leap forward in the international market. The new policy environment provides positive support fort this. Several of them seek to consolidate their strength through mergers and acquisitions. Note what a leading business magazine of India writes about the corporate plan of a leading large industrial group: "...suddenly the colour and shape of Ambani's money and ambitions are changing. From an earlier desire to dominate the Indian turf, the ambitions are taking on a global character; and the denomination of the money he is after has metamorphosed from the colourless rupee to greenbacks."[12] It has also been reported that Ambani's ultimate aim is to hit the *Fortune* 500 list of top companies.

Given the proper environment and encouragement, Indian corporations should also be able to become important players in the global market. Japan and the Asian tigers demonstrate that even devastated and developing economies can rapidly grow to become powerful forces to be reckoned with in the global economy.

If the Government and people of a country are vigilant, there will be nothing like the multinationals taking over the economy or undermining the national sovereignty as some critics try to frighten. In a bid to support their argument these critics say that the Britishers who had come here as traders established the East India company and ultimately became the rulers of the country. What is ignored by them is that the situation now is quite different from 1600 when the English East India Company was established and when 'India' consisted of a large number of kingdoms and principalities fighting with each other and seeking the help of the foreigners to put down the rivals, even subordinating themselves to the foreigners as a condition of the assistance. India today is a unified, powerful democracy, although suffers from internal strifes as in many other countries. The Indian electorate has shown, to the surprise of many political pundits, high political sensitiveness and maturity, particularly since the election of 1977.

---

[12] Sutanu Guru, "The Global Gameplan," *Business Today,* June 7-21, 1992, p. 26.

The new policy will certainly cause problems for many enterprises. It should however be noted that under any system or policy there are always many enterprises with serious problems. For instance, a large number of enterprises were reported sick in the Communist USSR. India too had a large number of sick units before the introduction of the liberalisations. There is no point in giving artificial respiration to sick units which cannot be made viable. Wasting resources on them would be a national sin. Restructuring and transition of the economy will have its own stresses and strain; but the short-sighted vested interests should not be allowed to undermine the long term national interests.

It is not that the new policy is without drawbacks and limitations. The structural and certain other weaknesses of the Indian industry will suffer the brunt of the new policy. The government policy and other constraints many a time came in the way of adopting the most efficient technology, including plants of economic size, in the past. Further, the high duties substantially increased the project costs. Many such enterprises are now asked to pay a price for the wrong government policy of the past.

Another problem which some industries are facing is that while their outputs are subject to international competition, they are not able, because of government policy, to procure their inputs at competitive prices. This is a clear instance of the policy drawback.

The Indian industry and government should be very vigilant to check dumping by foreign companies.

The transformation would have been more smooth if a substantial internal liberalisation had preceded the external liberalisation.

It may even become necessary to modify the policy on the basis of the new experience and environmental realities. New or more stringent regulations may also become necessary in some areas. What India undergoes now is a bold new experiment. By being behind many other countries in such an experiment, India missed all the advantages of the pioneers and early majority and is confronted with all the disadvantages of a laggard.

Demographic and Social Environment

India is undergoing very significant demographic and social changes.

The very large size of the population which is growing at a high rate indicates a substantial increase in demand for a large number of goods and services in comparison with advanced countries where the market for several products have either been stagnating or declining.

A very significant share of the Indian population is below the poverty line. Although these people, who do not have sufficient income even to meet the bare minimum basic necessities of life, do not come within the market for a large variety of goods and services, the existence of such a large size of poor population has a lot of other implications. To solve the basic problems, the additional employment to be created, the additional houses to be built, the additional number of children to be educated, the additional number of people to be provided with medical care, water supply etc. during one Five Year Plan in India are more than what most nations have done over centuries. While it is a formidable national challenge it also indicates enormous business opportunities.

The percentage of the Indian population who can afford many of the goods and services which characterise modern living is, of course, very small. However, in absolute terms this represents a sizable market. If we assume that ten per cent of the Indian population is affluent, in absolute terms it means a much larger number than the total population of each of the advanced countries except the United States and Japan.

It is interesting to note that besides China, only one country in the world, U.S.A., has a total population which is larger than the estimated size of the middle class in India (about 200 million).

There has been a considerable growth in the demand for the *white goods* in India and it will continue to grow. There are two contributory factors — a necessitating factor and a facilitating factor. The necessity for some goods is felt when the wife as well as the husband are employed and particularly when it is difficult to get maid servants. The rise in the household income due to more than one earning member facilitates the purchase of such goods.

The increase in the number of double and multiple income households increases the demand for a host products such as several consumer durables, packaged foods and several other consumer goods, quality education, day care, restaurants and so on. Employment of wife also tends to increase her role in purchase decision-making due to various reasons.

The Rise of the Rural Market

The rapid growth of the rural market for a number of products is another important development. The NCAER Survey (1987-88) has shown that the rural areas account for a large chunk of purchases of items like mechanical watches (71 per cent) mono-cassette recorders (61 per cent), table fans (54 per cent), motor cycles (45 per cent), quartz watches (44 per cent) and black and white T.V. sets. A very interesting finding was that a significant share of the consumer durables purchases have been made by people with very low incomes. It is significant to note the conclusion of the NCAER from the analysis of the Survey data: "It is patently false... to pretend that durables are used only by the pampered elite. The rich consume more, of course, that is why they are called rich. But the non-rich are major consumers too, running into millions. Curbing the consumption of consumer durables through taxes, and outright bans bill not affect the elite, who already own such goods, but will adversely affect poorer people who are not yet owners."

It is time that companies paid the attention to the rural market in their strategies. It is interesting to note that with the downward trend in the demand for motorcycles, the Hero Honda plans to aggressively push sales in the rural areas to keep up its sales. To flaunt the rural market, the company has introduced a sturdier model — the CD 100 SS. The company feels that "the growth, if any, is going to be in the rural areas. That is where the money is right now." It may be noted that Escort's *Rajdoot* has been doing well in the rural market.

The advent of television has added a new dimension to marketing strategies. T.V. advertising made significant contribution to the success of many products like Nirma, Maggie Noodles, Rasna and Pan Parag, to mention a few. The social transformation and the appeal of the T.V. have made children an influencing force in consumer purchase decision-making as is evinced by the significant attention paid to influencing children by many T.V. advertisements.

The television plays a very important role in product promotion and demand creation in rural areas, particularly in the light of the low literacy level and limited circulation of the print media. The television is an important contributor to the *revolution of rising expectations, demonstration effect, and conspicuous consumption.*

Future Trends

Following are some of the important possible future trends:

1. With the growing competition, product differentiation and positioning will become more important.
2. Class marketing/niche marketing will grow in importance and there will be a decline in the relative importance of mass marketing, barring certain exceptions.
3. The growing competition will also increase very considerably the importance of the *augmented product*. Levitt's comment that " the *new* competition is not between what companies produce in their factories but between what they add to their factory output in the

form of packaging, services, advertising, customer advice, financing, delivery arrangements, warehousing, and other things that people value"[13] will become very relevant in India to.

4. Companies will pay more attention to quality and price to survive in the competitive market.
5. The variety of products and product forms available in the market will significantly increase, substantially increasing the consumer choice.
6. Licensing, franchising and multi-level marketing will become more popular.
7. The societal marketing concept will gain more acceptance.
8. Direct marketing will gain more importance than today.
9. People with technical expertise and enterprise will have plentiful opportunities. It is pointed out that in future " industries would be neither capital-intensive nor labour-intensive but skill or enthusiasm intensive."[14]
10. Abundant entrepreneurial chances will be provided by the fast growing services sector.
11. Personal rewards, particularly at the managerial levels, will be linked to the results, much more than today. Even the tenure of employment will tend to be so linked in many companies.
12. The tendency of even well qualified people to opt for public sector jobs, because of the feeling of security of job despite the results, will considerably decline. There is likely to be an exodus of managerial and technical personnel from the public sector to the private sector.
13. Companies will tend to adopt a lean structure and cut the extra flap.
14. Indian business will become more integrated with the global business.

---

[13] Theodore Levitt, *The Marketing Mode* (New York: McGraw Hill, 1969) p. 2.

[14] Prof. N. Ranganathan, "Indian Market in the 90s — A Perspective."

3

Business and Society

Business is an integral part of the social system; and it influences other elements of society which, in turn, affect business. The type of products to be manufactured and marketed, the marketing strategies to be employed, the way the business should be organised, are all influenced by the social structure and the culture of a society. The social system, on the other hand, is influenced by the way the business functions. The organisation of the business, the way the business functions, innovations, transmission and diffusion of information and new ideas, etc., may affect society. Business activities have greatly influenced social attitudes, values, outlooks, customs, traits, etc. However, it is very difficult and, in some cases, almost impossible, to change many elements of the social environment in the short run. Hence, a business may have to adapt to these uncontrollable external environments, as indicated in the preceding chapter.

Changing Concept and Objectives of Business

The term *business* is used in different senses. In a functional sense, it is used to refer to the functions or activities of an organisation or individual. Sometimes it is used to refer to the enterprise or unit rendering the business. The term is also used in a very broad sense to embrace the whole business system.

Traditionally, the term *business* commonly referred to commercial activities aimed at making a profit or to organisations formed to make a profit. Indeed, in the past, economic theory made a fundamental assumption that profit maximisation was the basic objective of every firm. The modern outlook, however, is different. For many organisations, profit maximisation in the short run is not the primary objective. For them, profit is only secondary. There are, moreover, many organisations, both private and public, which do not aim at profit from their business. In short, the definition of a business as a commercial activity to make a profit or an organisation formed to make a profit is a narrow one. Yet, to a layman, business still means industry and commerce.

The old concept of business, confining it to commerce and private profit, has undergone a radical change. Today, business is regarded as a social institution forming an integral part of the social system. As Davis and Blomstorm observe, business is "a social institution, performing a social mission and having a broad influence on the way people live and work together".[1] As Calkins remarks: "It is now recognised that the direction of business is important to the public welfare, that businessmen perform a social function".[2]

Thus, "viewed in a broad way, the term *business* typically refers to the development and processing of economic values in society. Normally, we use the term to apply to the private (non-government) portion of the economy whose primary purpose is to provide goods and services to customers at a price, but the lines of distinction are getting hazy as business and government overlap their functions in organisations such as the Communications, Satellite Corporation and the Tennessee Valley Authority. In addition, *business* is a term applied to economic and commercial activities of institutions having other purposes, such as the business office of an opera association".[3] Thus, organisations which do not aim at making a profit, like the Madras Metropolitan Development Authority, charitable hospitals or other institutions, public relations organisations, government departments, etc., invest capital, price and market their products, services or ideas, manage their human resources, and so on.

The modern concept of business is, thus, a very broad one. Business is viewed as a subsystem of the total social system. According to Davis and Blomstorm, "our modern view of society is an ecological one. Ecology is concerned with the mutual relations of human populations or systems with their environment. It is necessary to take this broad view because the influence and involvement of business are extensive. Business cannot isolate itself from the rest of society. Today the whole society is a business's environment".[4]

Davis and Blomstorm point out that, in taking an ecological view of business in a systems relationship with society, three ideas are significant in addition to the systems idea. The three ideas are values, viability and public visibility.[5]

---

[1] Keith Davis and Robert L. Blomstorm. *Business, Society and Environment*, New York : McGraw-Hill, 1971, p. 11.

[2] Robert D. Calkins, "*The Problems of Business Education*, cited in Keith Davis and Robert L. Blomstorm, *Ibid.*, p. 3.

[3] Keith Davis and Robert L. Blomstorm, *op cit.*, p. 11.

[4] *Ibid.*, p. 12.

[5] *Ibid.*

Values

Business, like other social institutions, develops certain belief systems and values for which they stand, and these beliefs and values are a source of institutional drive. These values derive from a multitude of sources, such as the mission of business as a social institution, the nation in which a business is located, the type of industry in which it is active and the nature of its employees. These values become guides for employees' decisions in the interface of business. Second, they become strong motivators for people in a business.

Viability: Davis and Blomstorm define *viability* as the drive to live and grow, to accomplish the potential not yet reached, and to achieve all that a living system is capable of becoming. If a business is to be a viable, vigorous institution in society, it must initiate its share of forces in its own environment, rather than merely adjust to outside forces as a bucket of quicksand does. Every business needs a drive and spirit all its own to make it a positive actor on the societal stage rather than a reactor or a reflector. To expect the business to be otherwise is to deny it the opportunities available to other institutions, the authors have pointed out.

Public Visibility: The term *public visibility* refers to the extent that an organisation's activities are known to persons outside the organisation. Public visibility is different from the idea of a public image. The term *public image* refers to what people think about an organisation's acts, while public visibility refers to the extent to which its acts are known. The importance of public visibility is that it subjects business activities to public examination, discussion and judgement. If acts are not known, they cannot be judged.

In short, according to modern thinking, business is an integral part of the social system. It is a social organ to help accomplish the societal goals. Its activities and attitudes are, therefore, subject to public judgement, which may have far-reaching implications. A business enterprise shall make profit only by accomplishing the socially accepted goals and by satisfying society.

Objectives and Importance of Business

For quite a long time, it was held that the sole objective of business was maximisation of profit. But this is no longer a universally valid business objective. The memoranda of Association of Companies rarely state that profit maximisation is the primary objective.

Top executives of a large number of large companies and many economists today argue that profit is not the primary objective of a firm. Large companies, particularly, may strive to maintain or gain leadership in market share, sales volume, fixed assets, employment, etc., even sacrificing profit maximisation. According to William F. [illegible], the objective of a firm is not profit maximisation but sales maximisation, subject to a minimum profit constraint.

Even major shareholders, in many an instance, get greater satisfaction if their company has a dominant position rather than the objective of maximising profit. Most large firms are run by salaried managers who might not be interested in profit maximisation as much as the owners.

Now, it has also been recognised that some firms may limit profits rather than strive to maximise profits in the short run to discourage potential competition, to avoid public criticisum and government intervention, to restrain higher monetary demands by labour, to maintain customer goodwill, and so on.

The general outlook of large business corporations has undergone a change. As a result of the recognition of the social responsibility, business objectives have transcended the profit objective.

George Goyder, in his famous book, *The Future of Private Enterprise: A Study in Responsibility,* mentions the following as the principal objectives of a responsible company:

(i) The extension, development and improvement of the company's business and the building up of its financial independence.

(ii) The payment of fair and regular dividends to the shareholders.

(iii) The payment of fair wages under the best possible conditions to the workers.

(iv) The reduction in the prices to be charged to consumers.

In other words, the primary objectives of a socially responsible business should be to strengthen itself with due regard to the interests of the shareholders, employees and consumers.

A responsible company has certain secondary objectives as well. The important among them are:

(i) To enhance labour welfare;

(ii) To enhance customer service and goodwill;

(iii) To assist in developing and promoting the amenities in the locality;

(iv) To assist in developing the industry of which the firm is a member;

(v) To contribute to national goals.

A reasonable level of profit is not only compatible with the concept of a socially responsible business but also necessary for the discharge of social obligations and responsibility. As Goyder rightly observes, "in the responsible company, profits will continue to be the criterion of financial health.... As blood is the life of man, so are profits the life of industry, and just as man must maintain life before he can be free to pursue the life's objectives he has set before himself, be they horse racing or the mission field, so profits are necessary to business and are in the proper sense of the word 'primary'. But profits are not the ultimate objects of the responsible company."

There is a growing recognition that the business should pay due attention to the long-term welfare of society. The *marketing concept*, which has gained tremendous popularity, indicates that the key to satisfying organisational goals is customer satisfaction. The *societal marketing concept*, which has been gaining popularity over the marketing concept, however, calls for generating customer satisfaction and long-run consumer welfare as the key to attaining a long-run profitable volume,. As Philip Kotler points out, "the addition of long-run customer welfare asks the businessman to include social and ecological considerations in his product and marketing planning. He is asked to do it not only to meet his social responsibilities but also because failure to do this may hurt his long-run interests."[6]

Modern thinking, thus, expects the business to take on to itself the responsibility for serving or safeguarding societal interests as one of its important objectives.

It should not be inferred from what has been stated in the preceding paragraphs that modern thinking is against the idea of a business making a profit. It should be noted that it is essential that the company makes profits to achieve the various objectives stated above. But the objective of *profit maximisation* without regard to the societal aspects, including the interest of the employees, consumers and society, is no longer valid.

The various objectives of the business stated above indicate the profound importance of business in a modern society. As large amounts of resources are concentrated in the business sector, it should be expected to play a leading role in enhancing the material and social welfare of a nation. Business can significantly assist the development of backward areas, agriculture, export sector, etc., and can make a significant contribution to community development and social welfare.

The enormous resources at the disposal of large business corporations enable them to carry out extensive research and development. Norman Macrae's study of *Multinational Corporations* (MNCs) had revealed that of 100 largest economic units in the world, only 50 were nations and the remaining 50 were the largest of the 300 MNCs. Lester Brown, in his *World Without Borders*, had shown that all but 22 nations of the world had a GNP which was less than the total annual sales of *General Motors*. These facts are indicative of the resources at the command of the MNCs and of their economic importance. Despite their drawbacks, the large corporations have made very significant contribution in many areas. Because of their resources position, they should be expected to make a significant contribution to research and development, and undertake many challenging tasks. Indeed, they have enriched society by their inventions, including the introduction of a number of vital drugs.

---

[6] Philip Kotler, "What Consumerism Means for Marketers," in *Harvard Business Review*, May-June, 1972, p.54.

In short, as one of the leading Indian industrialists aptly observes, businessmen, being leading eminent and senior citizens who are also materially better placed, are expected to be pace-setters. They can provide the dynamism which can transform the country economically and socially. Their role is more than that of a mere manager or salesman.[7]

Professionalisation

The growth of management education and training has contributed to the growing professionalisation of management; and professionalisation has contributed to the growing social orientations of business.

Professonalisation imparts a certain social responsibility and dignity to management. *A professional is one who possesses systematic knowledge and skill to perform certain responsible functions with authority and who is bound by certain ethics in the use of his knowledge and skill.* According to Lewis Allen, "a professional manager is one who specialises in the work of planning, organising, leading and controlling the efforts of others and does so through a systematic use of classified knowledge, a common vocabulary and principles, and who subscribes to the standards of practice and code of ethics established by a recognised body."[8]

In this connection, Peter Drucker observes: "Management is independent of ownership, rank, or power. It is objective function and ought to be grounded in the responsibility for performance. It is professional–management is a function, a discipline, a task to be done; and managers are the professionals who practice this discipline, carry out the functions, and discharge these tasks. It is no longer relevant whether the manager is also an owner; if he is it is incidental to his main function, which is to be a manager".[9]

Drucker further remarks: "The professional has to have autonomy. He cannot be controlled, supervised, or directed by the client. He has to be private in that his knowledge and his judgement have to be entrusted with the decision. But it is the foundation of his autonomy, and indeed its rationale, that he sees 'himself as affected with the public interest'. A professional, in other words, is private in the sense that he is autonomous and not subject to political or ideological control. But he is public in the sense that the welfare of his client sets limits to his deeds and words".[10]

---

[7] H.S. Singhania, "The Pace-Setters," *The Economic Times*, August 3, 1980.

[8] Cited in S.A. Sherlekar, *Business Organisation and Management* (Bombay: Himalaya Publishing House, 1980.)

[9] Peter F. Drucker, *Management*, *op. cit.*, p. 6.

A professional has enormous responsibilities. He shall not use his knowledge, skill and authority unscrupulously. He shall not knowingly do harm to his customers. He is socially bound by the ethics of his profession.

From what have been stated above, it is clear that professionalisation of business management means that the business should be managed by men,

(i) who have formally acquired the specialised knowledge and skill for management;

(ii) who have authority and freedom to take the right decision;

(iii) who have no ideological bias in the discharge of the functions; and

(iv) whose decisions and actions are guided by certain ethical considerations.

Though progress has been made in the direction of professionalisation of management in India, there is still a long way to go, particularly in the many enterprises which are owned by one or a few families. Professionalisation does not, of course, mean that the owners shall not be the managers; but it certainly means that the managers should have proper management education and qualifications. In business circles, there has been a growing awareness of the need for professionalising management; and, as a result, many "family concerns" have taken steps for this purpose.

Professionalisation makes business more efficient, dynamic and socially responsible. The growth of management education in the country and the facilities abroad to obtain management education have contributed to professionalisation in the business field.

Government spokesmen have repeatedly stressed the need for professionalising management. But the irony is that the government have dealt a severe blow to professionalisation by appointing "professional" politicians in the top positions in several public sector organisations.

Business Ethics

The term *business ethics* refers to the system of moral principles and rules of conduct applied to business.

That there should be business ethics means that the business should be conducted according to certain self-recognised moral standards. Business, being a social organ, shall not conduct itself in a way detrimental to the interests of society and the business sector itself.

---

[10] *Ibid.*

A profession is bound by certain ethical principles and rules of conduct which reflect its responsibility, authority and dignity. The professionalisation of business management should, therefore, be reflected in the increasing acceptance of business ethics.

There is, however, no unanimity of opinion on what constitutes business ethics. In this connection, Peter Drucker very appropriately remarks: "There neither is a separate ethics of business, nor is one needed".[11] For "men and women do not acquire exemption from ordinary rules of personal behaviour because of their work or job. Nor, however, do they cease to be human beings when appointed vice-president, city manager, or college dean. And there have always been a number of people who cheat, steal, lie, bribe or take bribes. The problem is one of moral values and moral education of the individual, of the family, of the school". [12]

One is inclined to agree with Drucker that every individual and organ in society should abide by certain moral codes, and that there is no separate ethics of business.

However, certain norms and principles of conduct have been commonly advocated as constituting business ethics.

The most important professional ethics is expressed by the Hippocratic oath of the Greek physician : *Primum non nocere* ("not knowingly do harm"). This dictum implies that a professional should carefully evaluate his decision and ensure that his actions will not produce negative effects. Thus, this code rules out all antisocial business practices.

The code, *primum non nocere*, encompasses most business ethics. We may, however, list the important ethical principles that a business should follow.

(i) Do not deceive or cheat customers by selling substandard or defective products, by under-measurement or by any other means.

(ii) Do not resort to hoarding, blackmarketing or profiteering.

(iii) Do not destroy or distort competition.

(iv) Ensure sincerity and accuracy in advertising, labelling and packaging.

(v) Do not tarnish the image of competitors by unfair practices.

(vi) Make accurate business records available to all authorised persons.

---

[11] Peter F. Drucker, *op. cit.*, p. 366.

[12] *Ibid.* p. 366.

(vii) Pay taxes and discharge other obligations promptly.

(viii) Do not form cartel agreements, even informal, to control production, price, etc., to the common detriment.

(ix) Refrain from secret kickbacks or payoffs to customers, suppliers, administrators, politicians, etc.

(x) Ensure payment of fair wages to and fair treatment of employees.

Role of Trade Associations

Trade associations, which are voluntary organisations of businessmen formed to promote their common interests, can play an important role to promote business ethics.

Trade associations can promote business ethics in three important ways:

(i) *Education and Persuasion:* Trade associations can promote business ethics by educating the members in the importance of, and the need for, having business ethics, and persuading them to give due regard to ethical principles in the conduct of their business. The members should understand that if every businessman follows business ethics, everyone of them would be benefited and there would be an improvement in the general image of the business community in the eyes of the public.

(ii) *Code of Ethics:* Trade associations can formulate a Code of Conduct for their members. Such a code of conduct should also contain the code of ethics. The code of conduct will not only guide but also regulate the conduct of business by the members.

(iii) *Moral Sanctions:* "Sanctions" refer to the ways in which moral conduct is rewarded, or misconduct is punished. Such incentives and punishments should be expected to promote business ethics. A trade association may even debar a member for a serious violation of the code of conduct. Fear of such punishment might prompt members to refrain from unfair business practices. On the other hand, public recognition and reward for high moral standards in business might give a positive inducement to them to practise business ethics.

BUSINESS AND CULTURE

Business and culture are closely connected.

There are very varying definitions of *culture*. "Culture, in its broadest definition, refers to that part of the total repertoire of human action (and its product) which is socially, as opposed to genetically, transmitted". A very popular definition is that of E.B. Tylor : "Culture of civilization is that complex whole which includes knowledge, belief, art, morals, law, custom, and other capabilities and habits acquired by man as a member of society". Kluckhohn has defined culture very simply as "the total life-way of a people".

On the basis of the various definitions of culture, Francis Merill formulates the concept of culture as follows.[13] Culture, he says,

(a) is the characteristically human product of social interaction
(b) provides socially acceptable patterns for meeting biological and social needs;
(c) is cumulative, for it is handed down from generation to generation in a given society;
(d) is meaningful to human beings because of its symbolic quality;
(e) is learned by each person in the course of his development in a particular society;
(f) is, therefore, a basic determinant of personality; and
(g) depends for its existence upon the continued functioning of society but is independent of any individual or group.

Culture consists of both *material* culture and *non-material* culture. Material culture involves man-made things (e.g., automobile, television, telephone, etc.) and man-made alterations in the environment. Non-material culture includes such factors as language, ideals, beliefs, values, music, etc.

Elements of Culture

Culture, the sum total of societal behaviour, includes at least three elements, namely, knowledge and beliefs, ideals and preferences.

Knowledge and Beliefs: The knowledge and beliefs refer to a people's prevailing notions of reality. They include myths and metaphysical beliefs as well as scientific realities. As Rose remarks : "One of the features of culture in general that is of special sociological interest is the shared quality of a belief system. People who share a given culture tend to take a hostile attitude towards those within their midst who cannot, or will not, accept conventional definitions of fact". [14]

Ideals: Ideals refer to the societal norms which define what is expected, customary, right or proper in a given situation. Norms are enforced by *sanctions*, i.e., by rewarding the right behaviour and punishing the wrong behaviour.

Folkways and *mores* are important aspects of every culture. Folkways are norms of proper behaviour (like the proper way to greet a friend) that are informally enforced. But mores are norms of obligatory behaviour considered vital to the welfare of the group.

---

[13] Francis E. Merrill, *Society and Culture* (New Jersey; Prentice-Hall Inc., 1963), p. 116.

[14] Jerry D. Rose, *Introduction to Sociology* (Chicago: Rand McNally College Publishing Co., 1976), p. 58.

Preferences: Preferences refer to society's definitions of those things in life which are attractive or unattractive as objects of desire. Preferences may differ between cultures. Interestingly enough, the judgements of the ideal or the proper do not always correspond to our judgements of the pleasant or enjoyable. An example in point is the *temptations* (not proper but desirable). "All the things I really like to do are immoral, illegal, or fattening, " said Alexander Woollcott. [15]

"A culture tends to provide the standards of tastes in specific lines of human activity. Taste in the most liberal sense varies greatly with the food consumption preferences of different cultures. But there is also taste is clothing, housing sexual practices, and in an endless variety of possessions and activities. What is tasteful in one culture may be highly distasteful in another". [16]

Cultural characteristics are very important in the formulation of pragmatic business strategies. The cost of ignoring customs, traditions, taboos, tastes and preferences, etc., can be very high. For example, in Italy, a US company that set up a corn-processing plant found that its marketing efforts failed because Italians thought of corn as "pig food". The *Nestle* company brews more than 40 varieties of instant coffee to satisfy different national tastes. We have already made some reference to the values and beliefs attached to colour in different countries (See chapter 1 for details about the relevance of culture to business).

Organisation of Culture

The term *organisation of culture* refers to the social structure and the integration of traits, complexes and patterns that make up the cultural system.

That cultures are organised or integrated "does not mean that every single item of each culture is neatly and precisely integrated with everything else. It means rather that it is normal for the parts to be somewhat organised, and that culture traits receive their significance and meaning out of their relation to the rest of the culture". [17]

The social structure —"the web of organised relationships among individuals and groups that defines their mutual rights and liabilities"— together with traits, complexes and patterns, reflects the organisation of a culture.

Stratification, i.e., differentiation based on criteria such as age, sex, caste, occupation, education, income and so on, is an important aspect of the social structure and cultural organisation. Each stratum is assigned or supposed/expected to have a certain rank or position, role, or limitations etc., in the societal set-up.

---

[15] Cited by Jerry D. Rose, *Ibid.*, p. 59.

[16] Jerry D. Rose, *Ibid.*, p. 60.

[17] John F. Cuber, *Sociology: A Synopsis of Principles* (New York : Appleton Century Crofts Inc., 1959), p. 79.

The organisation of a culture is determined to a large extent by major social institutions. According to MacIver and Page, institutions are established forms or conditions of procedure characteristic of group activity. The group which performs these standardised actions has been termed by them an *association*. According to Biesanz and Biesanz, "institutions are clusters of norms organised and established for the pursuit of some need or activity of a social group, supported by the group's knowledge, beliefs, and values, as well as by the meaningful aspects of material culture". The important common institutions of modern cultures are :

The economic system; the political administrative system; the educational system; religion, family, expressionistic; aesthetic and recreational institutions, etc. Such institutions have been established to meet society's common needs of a biological, sociological, psychological, economic, and political nature— the type and nature of institutions reflect the common goals, aspirations and the ways of achieving them, definition and regulation of roles, positions, inter-relationships, etc., of the individuals and sub-groups and groups and the overall organisation of the culture.

Culture traits, complexes and patterns also help us to understand the organisation of a culture. A trait is a unit of observation. It may be a unit of normative behaviour, like shaking hands or saying *namaste*; or it may be an articraft, like a culture object such as a wooden bowl. As Lumby observes: "A culture trait is the simplest acquired material or activity pattern known; and these traits are the bricks, so to speak, of which the whole culture of the society is constructed". Most traits are related to others and fit into larger meaningful wholes called trait complexes. For example, the various traits involved in greeting and receiving a guest form a trait complex. A complex, thus, is a system of interrelated traits that function together as a unit number of complexes, in turn come together to form a culture pattern. A culture pattern "is a specific and enduring system of trait complexes". The organisation of culture may, thus, be looked upon from the point of view of a meaningful integration of different traits into interrelated complexes and complexes in turn into patterns. The term *culture pattern* is sometimes used to designate the overall organisation of the culture; but sometimes it is used to refer to the major segments of the culture, like the religious pattern of the *Todas*.

Cultural Adaptation

The term *cultural adaptation* refers to the manner in which a social system or an individual fits into the physical or social environment. The social system may be a small group, such as the family or a larger collectivity, such as an organisation, or even a total society, like a tribal society.

Adaptation is an essential quality for the survival of the individual and society. “Culture, a uniquely human attitude, is something which man interposes between himself and his environment in order to ensure his security and survival. As such, culture is adaptative”. Leslie A. White speaks of culture as “a specific and concrete mechanism employed by a particular animal organism in adjusting to its environment”, and Ralph Piddington holds that “culture is essentially an adaptative mechansim, making possible the satisfaction of human needs, both biological and social”.

As MacIver and Page observe, [18] “the correspondence of life and environment is amply illustrated in the case of social groups. Just as every region of a country is in some respects different from every other, so also are the inhabitants of each region..... The difference in some way is relative to the environment in which they respectively dwell..... Common observation tells us that as people change from country to city, from agriculture to industry, from mountain to plain, from hot to temperate climates, they become adjusted to the new conditions, undergoing a process of change as their environment changes. It is obvious that a well-to-do group has a different environment from a poor one, a coloured urban group from a white one, a professional class from an artisan class. Take the largest effective community we can find, whether that of a nation or of a whole area of civilization, and its character is seen to be in some significant way related to that of the total environment within which it has grown. Or take the smallest group, such as the individual family, and there too the correspondence between life and environment is manifested”.

Adaptation is essential for survival. The type of clothing, food and dwelling, suitable for the climatic and weather conditions, are forms of adaptations. Cultures are many times compelled to adapt to outside forces or environmental changes. Take the case of some of the tribe societies in India. The invasion of the “outsiders” destroyed or damaged their environment, making it impossible or very difficult for them to survive with the traditional ways of life. Hence, now they take up “wage employment outside” and have changed their life styles, including their food habits and dress. Some of them live in the houses provided by the Government which are quite different from their traditional dwellings.

Cultural adaptation can be viewed in a very wide context. We have adapted to the energy crisis caused by the oil price hikes by modifying our energy policy and intensifying oil exploration, developing alternative source of energy and restricting oil consumption. Humanity adapts to contagious diseases by immunisation.

---

[18] R.M. MacIver and C.H. Page, *Society : An Introductory Analysis* (London : Macmillan, 1959), p. 74.

Adaptation is relevant at the individual level as well. An individual who joins or accepts a new religion has to adapt himself to the beliefs and ways of that religion. A worker who becomes a member of a trade union has to fit into the objectives, rules and ways of the union. A woman who lives with her husband's family would have to fit into that family culture. An Indian who settles in the U.S.A. has to adjust to the social and physical environments there. A person who wants to enter a Hindu temple has to adapt himself to the culture (for example, the footwear has to be removed; in some cases, only a specified type of clothing shall be used; a person who wants to make pilgrimage to Sabarimalai has to adapt himself by strictly adhering to the religious regulations in operation there).

Environmental changes sometimes produce *cultural shock*–a feeling of confusion, insecurity, and anxiety caused by the strangeness of the new environment. For example, if an youngster, born and brought up in a large city, is posted to a bank office in a remote village, he may experience a cultural shock. Similarly, a villager may experience a cultural shock when he takes up a job in a large modern company in a far-away metropolitan city. They have, however, to adapt to the new culture in due course if they want to survive.

In short, "every difference of environment means a difference in our habits, our ways of living. On the other hand, our habits, our ways of living, in so far as they differ, create for us a different environment, a different selection within it, and a different accommodation to it. Through a process of constant selection and constant adaptation, the moving equilibrium of life is maintained". [19]

Sometimes it is necessary to know the process and nature of the cultural environment for a successful formulation of business strategies. For example, while introducing new ideas, techniques, products; while segmenting the market; while formulating the product and promotion mix strategies; one should consider the extent to which different categories of consumers adapt to the new things or environment and the factors favouring and disfavouring adaptations (and also the general attitude of society to the new ideas and environment and their impact on different categories of consumers).

Cultural Transmission

A very important character of culture is its transmissive quality. The elements of culture are transmitted among the members of the culture, from one generation to the next, and to the new members admitted into the culture. Some of the aspects of a culture may be transmitted to other cultures also.

---

[19] R.M. MacIver and C.H. Page, *Ibid.*, p. 74.

The transmissive quality of culture makes it cumulative. Every generation inherits a stock of cultural elements, many of which have been accumulated over a long period of time. As time goes on, cultures accumulate more techniques, ideas, products and skills. It is also quite obvious that certain old elements are dropped as new ideas and traits are acquired.

Cultural accumulation, facilitated by cultural transmission, enables man to build upon the achievements of the past.

Many cultural behaviours are handed down by one's parents, teachers and other elders. The *reference groups* play an important role in handing down new traits and ideas. Some cultural behaviours are, however, "handed up " to the elders. It is not uncommon to come across elders imitating or adopting some of the new traits of the youngsters who are the trend-setters. Cultural transmission is not only downward and upward; a lot of transmission takes place among contemporaries, too, e.g., styles of dress; recreational fads; reading and learning habits; political, social and economic views, These are often transmitted among contemporaries. Cultural transmission, thus, takes place horizontally as well as vertically.

The process of cultural transmission involves teaching and learning. One hardly acquires a behaviour pattern spontaneously. One rather learns it. However, as Cuber points out, "much of the learning process, both for the teacher and the learner, is quite unconscious, unintentional, or accidental; but it is learning and teaching nevertheless". [20]

Cultural transmission takes place by means of symbolic communication. A *symbol* is any sign, signal or word that conveys a meaning. The great importance of language in cultural transmission is quite clear. Literature, film, TV and some other electronic gadgets, social institutions, advertising and marketing techniques, and so on, play very important roles in cultural transmission.

Transmission also facilitates cultural diffusion, i.e., the spread of cultural elements from one area to another. Cultural transmission and diffusion are easy in a culture with high educational levels and a well-organised communication system. An effective communication system and high educational levels facilitate socio-economic change through better cultural transmission and diffusion, for new ideas and innovations are easily and quickly transmitted, diffused and absorbed in such a culture. In the context of the generally low literacy rates in India, the government has realised the importance of the media, such as film, television and radio, in transmitting useful information such as better agricultural practices and techniques, market information, the concept and importance of family planning, and so on.

---

[20] John F. Cuber, *op. cit.*, p. 66.

The nature and process of cultural transmission and diffusion in a society is important to business decision-making. For example, to formulate a promotional policy for a product, a service or an idea, it is important to identify the relevant elements of transmission, to evaluate the relative effectiveness of alternative communication media, to identify the *reference groups* and the extent of their influence, to identify the channel of influence on the reference groups, and so on.

Cultural Conformity

Individuals in a culture tend either to conform to the cultural norms or to deviate from them. If the culture endures as it is, most people would conform to the norms. As Inkeles observes, "the social order depends on the regular and adequate fulfilment of the role obligations incurred by the incumbents of the major status-positions in a social system. It follows that the most important process in society is that which insures that people do indeed meet their role obligations".[21]

A student who abides by the rules of his school discipline, does his homeworks promptly and studies properly is conforming to his role obligations. Similarly, an employee who works properly is conforming to his role obligation. And an employee who strikes work for a reasonable cause in response to a strike call by his union is also conforming to his role as a member of the union. "When an individual has incorporated within himself the knowledge and appropriate skills necessary to the fulfilment of a role, and when he accepts the value or appropriateness of the action, sociologists speak of his having 'internalised' the role and its psychological underpinnings".[22] Such internalisation helps achieve cultural conformity.

As Biesanz and Biesanz remark: "Conformists may be so thoroughly socialized that it never occurs to them to question the norms. They may repress contrary impulses, or may sublimate them into approved kinds of activity. On the other hand, conformists may be aware of impulses to deviant behaviour but may not give in to them for any of the following reasons:

(i) Through the process of self-interaction, they exercise self-control, knowing that the cost of deviant behaviour would be guilt, shame, and loss of self-esteem.

(ii) They want to keep the approval of their significant others.

(iii) They may fear punishment, ostracism, loss of their jobs, citizenship, freedom, or life.

(iv) They may see no point in deviating from the straight and narrow if the rewards of deviants do not seem glamorous.

---

21. Alex Inkeles, *What is Sociology*? (New Delhi : Prentice-Half of India Pvt. Ltd., 1975), p. 79.

22. *Ibid.*, p. 79.

(v) They may simply have no opportunity for deviant behaviour despite fantasies and impulses toward it". [23]

Conformity to role obligations is enforced largely by means of *sanctions*, i.e., *rewards and punishments*. The negative sanctions range from very mild punishment to sentence of death. Today, greater stress is laid on education and *motivation* than on negative sanctions to induce the incumbents to conform to their status positions.

Certain kinds of conformity, however, are not good from the point of the long-term interest of society, for they stifle the constructive innovation that produces the necessary social changes. For example, blind conformity to the status quo, yielding to group or strong individual pressures against one's better judgement may prove to be detrimental. Some measure of courage and inclination to deviance on the part of the individual according to his conscience and judgement are necessary for social change and progress. It may be recalled that deviances such as civil disobedience and strong protest against foreign rule led by Gandhiji helped win independence for India.

A knowledge of the nature and extent of cultural conformity and deviance will sometimes be helpful in business decision-making. If a society is, by and large, characterised by blind conformity, it would be very difficult to market new revolutionary ideas (including products and techniques) in such a society. Special efforts may be required in such a society to change the attitudes of the people in favour of unconventional ideas. It is also important to understand the extent and nature of the snow-balling effects of initial deviations in a society.

TECHNOLOGICAL DEVELOPMENT AND SOCIAL CHANGE

According to Han Gerth and Wright Mills, social change refers "to whatever may happen in the course of time to the roles, the institutions or the orders comprising the social structure : their emergence, growth and decline". To Morris Ginsberg, social change means a change in the social structure, e.g., the size of a society, the composition or balance of its parts or the type of its organisation. As Biesanz and Biesanz observe : "social change includes significant alterations in social structure, in cultural definitions, and in the products of socio-cultural action. Social structure may change in size, in the degree of formality and informality, in the types of social relationships, and in the system of statuses and roles. Cultural change is reflected in changing knowledge, beliefs, values and norms. Material products will change as a result of advances in science and technology". In short, social change may involve any one or more of the following : changes in the size of society; changes in social institutions; changes in occupational patterns;

---

[23] Mavis Hiltunen Biesanz and John Biesanz, *Introduction to Sociology* (New Jersey; Prentice-Hall Inc., 1978), p. 108.

changes in positions, status and roles; changes in values, beliefs and attitudes; changes in social interactions; changes in social mobility; and so on.

Social change is brought about by a number of factors--technological, cultural, demographic, biological, economic, environmental, psychological, political, etc.

Technology, i.e., the practical application of scientific knowledge, is one of the important determinants of social change. "The rapid changes in our society are obviously related to, and somehow dependent upon, the development of new techniques, new inventions, new modes of production, new standards of living".[24] Indeed, technology has profoundly altered social attitudes and modes of life. "Attitudes, beliefs, traditions, which once were thought to be the very expression of essential human nature, have crumbled before its advance".[25]

The industrial age has profoundly changed the social life and status of women. "Industrialization destroyed the domestic systems of productions, brought women from the home to the factory and the office, differentiated their tasks and distinguished their earnings. Here is the new environment, and the new social life of women is the response".[26] The introductions of new techniques for the processing and preservation of food and the appliances to perform kitchen and other domestic work facilitated the emancipation of women from the kitchens.

The impact of developments in the field of transport and communications on society is very profound. The automobile and telephone made suburbanization possible in the USA and other countries. Films, television and radio have become very helpful in the transmission and diffusion of information and in the education of the common man. These media play an important role in bringing about social change. Television or radio enables a person to address, at one time, millions and millions who are geographically widely spread. Free radio and television make possible the rapid rise of new political and social movements. No wonder that, in a number of countries, these media are monopolised or controlled by the state, which uses them for propaganda purposes. These media have brought about significant changes in the sphere of family and individual recreation. Such technologies have considerably reduced the social distance between the urban and rural areas.

Modern industrialisation, a product of technological development, has upset the social structure. It has administered a severe blow to the caste system. Social mobility has become very conspicuous. Society has become more materialistic. Industrialisation has also given rise to class conflicts.

---

[24] R.M. MacIver and C.H. Page, *op. cit.*, p. 553.

[25] *Ibid.*

[26] *Ibid.*

The industrial, agrarian and transport revolutions have brought about another great revolution–the urban revolution. Urbanisation has drastically transformed social life.

Technological developments have enabled man to control his physical environment to some extent and to harness the natural resources better. Air conditioners have made life more comfortable. Huge dams are built to control floods, generate power and to irrigate land. Experiments to produce artificial rains have shown positive signs of success.

Technological developments have made material progress rapid and widespread, though unequal. And the social attitude in general has become more materialistic.

Technological developments have a number of adverse effects on society. Some of the technology–induced developments have caused serious ecological problems--pollution, for example. The film is said to be having some immoral effects on society. There is a criticism that many Indian movies encourage crime, rape, alcoholism and violence. Technology is regarded as one of the factors responsible for the concentration of economic power in a few hands. Some sociologists are of the opinion that capitalism is merely a by-product of mechanisation. Developments in the field of nuclear science, though they offer great scope for advancement, pose a serious threat to the very survival of the human race. "But to condemn technology altogether is to forget that it also saves lives, makes desert bloom, and lets us hear music in our living rooms."

CULTURAL LAG

The *cultural lag* thesis put forward by William F. Ogburn says that the various parts of modern culture do not change at the same rate, and that since there is a correlation and interdependence of parts, a rapid change in one part of our culture requires readjustments through other changes in various correlated parts of that culture. These readjustments are often difficult, if not impossible, to make because of a variety of factors, ranging from ignorance to active resistance. Technological changes call for adaptive changes in non-material culture, which is inherently conservative. The cultural lag thus places constraints on the scope of social change through technological development. For example, in some cultures, social inertia and religious sentiments come in the way of population control, though a variety of techniques are available for birth control. The important factors that contribute to cultural lag include ignorance, wrong notions, conservatism, sentimental factors, political factors and vested interests.

The message of cultural lag to the business is that to successfully market a new idea (including product, service, technique), it is necessary to identify the factors causing the lag and to overcome them by taking appropriate measures.

The preceding pages have given a glimpse of a number of important elements and aspects of the social system that have implications for a business, and have indicated several inter-relationships between business and society. Indeed, business and society are very intricately intertwined, acting and reacting upon each other.

4

Social Responsibility of Business

Today the operations of business enterprises affect a wide spectrum. The resources they make use of are not limited to those of the proprietors and the impact of their operations is felt also by many a people who are in no way connected with the enterprises. The shareholders, the suppliers of resources, the consumers, the employees, the local community and society at large are affected by the way an enterprise functions. Hence a business enterprise has to be socially very responsive so that a social balance may be struck between the opposing interests of these groups.

Goyder argues : "Industry in the twentieth century can no longer be regarded as a private arrangement for enriching shareholders. It has become a joint enterprise in which workers, management, consumers, the locality, Government and trade union officials all play a part. If the system which we know by the name private enterprise is to continue, some way must be found to embrace many interests which go to make up industry in a common purpose."[1] Later,in 1978, while delivering the C. C. Desai Memorial Lecture, he reiterated his plea that if the corporation has to function effectively, it has to be accountable to the public at large; and he sought to equate the suggestion of a responsible company with the trusteeship concept advocated by Gandhiji, the aim of which was to ensure that private property was used for the common good. The declaration issued by the international seminar on social responsibility of business held in India in 1965 also co-related the Gandhian concept of trusteeship with the social responsibility of business as "responsibility to customers, workers, shareholders and the community."

There has been a growing acceptance of the plea that business should be socially responsible in the sense that the business enterprise, which makes use of the resources of society and depends on society for its functioning, should discharge its duties and responsibilities in enhancing the welfare of the society of which it is an integral part. The High-Powered Expert Committee on Companies and MRTP Acts (Sachar Committee), in its Report submitted to Government in August 1978, observed that, "in the development of corporate ethics, we have reached a stage where the question of the social responsibility of business to the community can no longer be scoffed at or taken lightly".[2] The Committee further points out that, "in the environment of modern economic development, the corporate sector no longer functions in isolation. If the plea of the companies that they are performing a social purpose in the development of the country is to be accepted, it can only be judged by the test of social responsiveness shown to the needs of the community by the companies. The company must behave and function as a responsible member of society, like any other individual. It cannot shun moral values, nor can it ignore actual compulsions. The real need is for some focus of accountability on the part of the management which is not limited to shareholders alone. In modern times, the objective of business has to be the proper utilisation of resources for the benefit of others. A profit is still a necessary part of the total picture; but it is not the primary purpose. This implies that the claims of various interests will have to be balanced, not on the narrow ground of what is best for the shareholders alone but from the point of view of what is best for the community at large. The company must accept its obligation to be socially responsible and to work for the larger benefit of the community".[3]

---

[1] George Goyder, *The Future of Private Enterprise: A Study in Responsibility* (Oxford: Basil Blackwell, 1951), p. 1.

H.S. Singhania classifies the nature of the social responsibility of business into two categories.

(a) The manner in which a business carries out its own business activity; and

(b) The welfare activity that it takes upon itself as an additional function.

The first involves the acceptance of the fact that business is not merely a profit-making occupation but a social function which involves certain duties, and requires that appropriate ethics are followed. For example, a business must obey all the laws, even when they are disagreeable; it should produce the maximum goods of good quality, ensure smooth supplies at competitive prices, pay taxes, shun malpractices, pay a fair wage to employees and a reasonable dividend to shareholders. It is also the duty of a business to undertake new investment and promote the dispersal of economic activity through ancillarisation and the setting up of industries in backward areas so as to spread enterprise and take employment to the doorsteps of labour. In addition to its commercial activity, business also plays a role in promoting social welfare activity, even directly.[4]

---

[2] Government of India, *Report of the High-Powered Expert Committee on Companies and MRTP Acts* (New Delhi : Controller of Publications, August 1978), p. 95.

[3] *Ibid.*, p. 110.

Responsibility to Shareholders

The responsibility of a company to its shareholders, who are the owners, is indeed a primary one. The fact hat the shareholders have taken great risk in making investment in a business should be adequately recognised.

To protect the interests of the shareholders and employees, "the primary business of a business is to stay in business". To safeguard the capital of the shareholders and to provide a reasonable divdend, the company has to strengthen and consolidate its position. Hence, it should develop and improve its business and build up its financial independence.

Needless to say, to provide dividend, the company should earn a sufficient profit. Adequate reserves should be built up so that it will be able to declare a reasonable dividend during a lean period as well.

If a company continuously suffers losses, not only will it not be able to pay dividends, but the value of its shares will fall and result in the erosion of the shareholders' capital. Hence, to discharge its responsibilities to the shareholders, a company shall earn sufficient profit.

If a company fails to cope with changes in a changing and dynamic world, its position will be shaken, and the shareholders' interests will be affected. By growth, innovation and diversification, the company should consolidate and improve its position and help strengthen the share prices.

The shareholders are interested not only in the protection of their investment and the return on it but also in the image of the company. It shall, therefore, be the endeavour of the company to ensure that its public image is such that the shareholders can feel proud of their company.

It may be mentioned here that the shareholders also have certain responsibilities which they have to discharge to protect their own interests. They shall not only offer whole-hearted support and co-operation in the positive efforts of the company but shall also guide and control properly its policies and activities. At the same time, they shall appreciate the responsibility of the business to other sections of society — to the workers, consumers and the community.

Responsibility to the Employees

The success of an organisation depends to a very large extent on the morale of the employees and their whole-hearted co-operation. Employee

---

[4] See H.S. Singhania, "The Pace-Setters", *The Economic Times*, August 3, 1980.

morale depends to a large extent on the discharge of the company's responsibilities to them and the employer-employee relationship. The responsibility of the organisation to the workers includes:

(i) The payment of fair wages ;

(ii) The provision of the best possible working conditions;

(iii) The establishment of fair work standards and norms;

(iv) The provision of labour welfare facilities to the extent possible and desirable;

(v) Arrangements for proper training and education of the workers;

(vi) Reasonable chances and proper system for accomplishment and promotion;

(vii) Proper recognition, appreciation and encouragement of special skills and capabilities of the workers;

(viii) The installation of an efficient grievance handling system;

(ix) An opportunity for participating in managerial decisions to the extent desirable.

The Committee that conducted the "social audit" of Tata Iron and Steel Company (TISCO) observes that "not only should the company carry out its various obligations to the employees as well as the larger community as a matter of principle, but this has also led to a higher degree of efficiency in TISCO works and an unparalleled performance in industrial peace and considerable team spirit and discipline which have all resulted in high productivity and utilisation of capacity". Thus, by discharging its responsibilities to the employees, the business advances its own interests.

It may, however, be pointed out that the expenditure on labour welfare, etc., should have relevance to the financial position of the company and the economic conditions of the nation. This aspect has to be particularly taken note of by public sector enterprises. Such expenditure shall not exceed the socially and economically warranted limits and shall not cause undue burden on the consumers or the general public. It shall not result in the formation of islands of affluence or comfort in the midst of proverty and suffering at the expense of society.

Responsibility to Consumers

According to Peter Drucker, the famous writer on management, "there is only one valid definition of business purpose; *to create a customer*". Drucker observes; "The customer is the foundation of a business and keeps it in existence. He alone gives employment. To supply the wants and needs of a consumer, society entrusts wealth-producing resources to the business enterprise".

It has been widely recognised that customer satisfaction shall be the key to satisfying the organisational goals. Among the important responsibilities of the business to the customers are:

(i) To improve the efficiency of the functioning of the business so as to (a) increase productivity and reduce prices, (b) improve quality, and (c) smoothen the distribution system to make goods easily available;

(ii) To do research and development, to improve quality and introduce better and new products;

(iii) To take appropriate steps to remove the imperfections in the distribution system, including blackmarketing or profiteering by middlemen or anti-social elements;

(iv) To supply goods at reasonable prices even when there is a seller's market;

(v) To provide the required after-sales services;

(vi) To ensure that the product supplied has no adverse effect on the consumer;

(vii) To provide sufficient information about the products, including their adverse effects, risks, and care to be taken while using the products;

(viii) To avoid misleading the customers by improper advertisements or otherwise ;

(ix) To provide an opportunity for being heard and to redress genuine grievances;

(x) To understand customer needs and to take necessary measures to satisfy these needs.

Despite the popularity of the *marketing concept* and the growing awareness of consumer rights, consumers all over the world are, by and large, dissatisfied. *Consumerism*, which is an organised endeavour of the consumers *to protect their rights*, is a manifestation of this fact. In shortage economies like India's, many businessmen pay scant attention to their responsibilities to consumers. To protect consumer rights and to make the business discharge its responsibilities to them, the consumers should give up their indifferent attitude and build up a strong consumer movement.

Responsibility to the Community

A business has a lot of responsibility to the community around its location and to the society at large. These responsibilities include:

(i) Taking appropriate steps to prevent environmental pollution and to preserve the ecological balance;

(ii) Rehabilitating the population displaced by the operation of the business, if any;

(iii) Assisting in the overall development of the locality;

(iv) Taking steps to conserve scarce resources and developing alternatives, wherever possible;

(v) Improving the efficiency of the business operation;

(vi) Contributing to research and development;

(vii) Development of backward areas;

(viii) Promotion of ancillarisation and small-scale industries;

(ix) Making possible contribution to furthering social causes like the promotion of education and population control;

(x) Contributing to the national effort to build up a better society.

The Indian Situation

The Indian business sector presents a mixed picture as far as social responsibility is concerned. J.R.D. Tata, who has been instrumental in conducting the first social audit in India and perhaps in the world, is of the opinion that while on the side of production, of growth, of efficiency, Indian industry has, on the whole, done remarkably well, usually against odds and in spite of crippling infrastructural shortages unknown in advanced countries, on the distributional side, however, its record has often been poor and, in some respects, dismal, judged by the size of the blackmarket, the volume of black money and the general corruption that pervades our economic life. [5]

True, many a time the imperfections on the distribution side mostly — hoarding and blackmarketing-mercilessly gouge the unfortunate consumer. "Although it is the trader rather than the manufacturer who is mainly responsible for such diversion of goods and for the resulting heavy burden imposed on the consumer, the fact remains that, to that extent, corporate management of even of large Indian industries has, perhaps unavoidably, failed in the important obligation of ensuring that their goods reach the consumer at fair prices". [6] It is high time the producer realised that his responsibility does not end with producing goods and services; he should ensure that whatever is produced reaches the ultimate consumer in time and at reasonable prices.

It is gratifying to note that a number of leading companies in India have shown recognition of the social responsibility of the corporate sector. The business community has been instrumental in setting up hundreds of institutions of public service like schools, colleges, management institutes, dispensaries, hospitals, technological institutes, research institutes (medical, scientific and technological), libraries, dharamshalas,

---

[5] J.R.D. Tata, "A Matter of Expectation", *The Economic Times*, August 3, 1980.

[6] *Ibid.*

cultural institutions, institutes for the dumb, deaf and blind, museums and places of religious worship. Some of the leading enterprises have extended welfare measures like health and medical facilities to people of the surrounding villages. Many businessmen have risen up to the occasion to help the victims of droughts, floods, earthquakes and other natural calamities.

One of the important *externalities* of industrialisation is the serious ecological damage it has inflicted. The problem of environmental pollution caused by industries is very serious in a number of places in our country. Though some enterprises have taken pollution abatement measures, many—both in the private and public sectors — continue to be major offenders against the environment. In fact, some of the public sector enterprises are notorious for their irresponsibility in this matter.

As J.R.D. Tata rightly points out,[7] high standards of behaviour and the discharge of social obligations should be expected of or demanded from, not only business and industry but from all economic groups in the country whose actions have an impact on the public weal. This applies in particular to trade unions which, both in India and abroad, have, in recent years, acquired and often misused enormous economic powers, exceeded only by the Government's own. The millions of man-days of production lost in India every year owing to labour unrest and the violent form which such unrest has taken in many cases, clearly indicate the need for a new approach to trade unionism and a recognition of its social obligations.

The participation of labour in management has been suggested as a remedy for many a cause of industrial unrest. While it is a welcome suggestion, it should be ensured that the "collaboration" between labour and capital does not become instrumental in exploiting society. As long as labour gets its slice of the cake, it would support capital to amass profit by exploiting society.

The social responsibility of business is usually advocated for the private sector, presumably on the assumption that the public sector is socially quite responsible. But the fact remains that the public sector in India has yet to prove that it is more responsive to society than the private sector. In some cases, in fact, the record of the public sector is more dismal than that of the private. As far as the pollution of the environment is concerned, the public sector is as guilty as the private.

Many public sector enterprises in India have undoubtedly failed to discharge their primary responsibilities–ihcrease in the productivity and production, efficiency in the provision of the services, etc. This is reflected in the mounting losses of many public enterprises. Some may argue that the public sector is not, and should not be, profit-motivated. But gone are the days of such philosophy. It has been clearly laid down that the public sector should generate surpluses to finance our future development programmes. The huge losses incurred by the Indian public sector are not the result of any charity; they are the inevitable outcome of inefficiency, irresponsibility and mismanagement at various levels. The failure of the public sector in discharging its primary duties has made the plight of the common man worse than it would have been, for it resulted in shortages, higher prices and more taxes. There is also a very wide gap between the sweet expectations from the public distribution system designed to save the common man from the clutches of the " unscrupulous private sector" and the bitter experiences of the way the public distribution system functions. The least said about the efficiency of the service of the public sector transport the better. In our country a social audit is needed, perhaps, more of the public sector than the private sector.

---

[7] *Ibid.*

The Sachar Committee has suggested that companies in the public sector, which are very much a part of the total corporate sector and account for about 70 per cent of the total investment in the corporate sector, must reckon with the social costs and social benefits arising out of any given investment. As a matter of fact, social cost-benefit analysis is accepted as one of the prime considerations for making any investment in the public sector. It is natural, therefore, to expect from the private corporate sector that, in the matter of investment, it will also show a similar consideration of social cost and social benefit. The accountability of the public sector to the people through Parliament must find its parallel in the private sector in the form of social accountability, at least to the extent of informing the public about the extent and manner in which it has or has not been able to discharge its social obligations in the course of its own economic operations. It is in this sense that the social responsibility of business, as far as the private sector is concerned, is another name for social accountability and is, in our view, a mere extension of the principle of public disclosure to which the corporations must be subject. It has also been repeatedly emphasised that the report on social responsibility of the company should not be in a vague or general manner, but should have an element of particularisation and certainty.[8]

Social Audit

The Committee set up by the Tata Iron and Steel Company Limited (TISCO) to conduct the Social Audit of the TISCO points out that though social audits have been undertaken in a number of countries, pricipally in the U.S.A. (to which the practice owes its origin), Japan, the U.K. and one or two other Western countries, the subject has not yet attained the status of a science. There is no agreement, much less unanimity, among its most ardent proponents, particularly as to its basic principles or its true objectives. It is only a child of the last decade, during which there has been a growing concern about the environment and the problems of pollution, consumer protection, workers' safety and equal employment opportunities.[9] Melvin Anshen, Professor of Public Policy and Business Responsibility at the Graduate School of Business, Columbia University, and an eminent authority on the subject, remarks that "the social audit has been described as an idea whose time has come but which isn't ready to be taken off the drawing board and put to work".[10]

---

[8] Government of India, *op. cit.*, p. 96.

Dr. Clark C. Abt, in his book *Audit for Management*, suggests that a Social Audit should, as far as possible, be approximated to an ordinary commercial audit; that this should be based on a social balance sheet with a "credit" side and "debit" side. He calls them "inputs" and "outputs" or "costs" and "benefits" so far as the social balance sheet is concerned. After suggesting that every "input" and "output" must be measured in terms of dollars or other currency, he points out that the basic purpose of a business corporation is to maximise the financial return, earned on its financial investment plus the amount of social return on its social investment. To make rational investment decisions in the social areas, it is necessary to know the social costs and if we are to assess them by the same measure as of financial investment, this must be expressed in dollar terms. He further asserts that, sooner or later, the social balance sheet must become a mandatory part of the normal commercial balance sheet of the company.[11]

The Sachar Committee observes that the acceptance of the concept of social responsibility must be reflected in the information and disclosures that the company makes available for the benefit of its various constituents—shareholders, creditors, workers and the community — and has suggested that a provision may be made in the Companies Act that every company shall give a social report which will indicate and quantify, in as precise and clear terms as possible, the various activities relating to social responsibility which have been carried out by the company in the previous year.[12] The Committee has further suggested that it is possible that a company may be required to alter its memorandum with respect to the objects of the company so as to carry out its activities as an obligation to the concept of social responsibility.[13] It should be pointed out here that the TISCO had, in 1970, voluntarily incorporated in its Articles of Association its social and moral responsibilities to the consumers, employees, shareholders, society and the local people.

---

9. *Social Audit Committee Report* (Bombay : TISCO, August 1980), p. 2.
10. *Ibid.*, p. 3.
11. Cited in the *Social Audit Committee Report*, p. 3.
12. Government of India, *op. cit.*, p. 98.
13. *Ibid.*, p. 98.

5

Consumer Rights, Consumerism and Business

An important socio-political environment confronting the business is the growth of consumerism and the legislative measures to protect the consumers. Consumer movement had its conspicuous beginning and development in the United States. There has been a growth of consumer awareness in most countries leading to growth of consumerism and growing demand for consumer protection.

Though consumerism is still in its infancy in India, there are several consumer organisations like the Consumer Guidance Society of India (CGSI) and the Consumer Education and Research Centre (CERC) which are doing commendable work. Some of these organisations are very active in conducting product testing and exposing substandard quality and adulteration. The demand for regulatory measures for consumer protection have been substantiated by the results of such tests. ISI certification of food colours, demanded by the C.G.S.I., is now mandatory. Consumer organisations also play an important role in redressing consumer grievances.

Consumer movement is growing, *albeit* slowly, in India. It may gather momentum from the growing consumer awareness and the growing feeling that the consumer is ruthlessly exploited and taken for a ride. It is said that the Indian consumers are cheated to the tune of Rs.2000 crores annually through various devises invented by the clever businessmen and traders.[1] 18 out of 22 pressure stoves tested at the instance of the CGSI failed important safety tests and all thermometres tested failed to register temperature accurately. Many products have been so tested by various consumer organisations and they have been demanding governmental action ensuring quality standards. In short, the business can no more take the consumer for granted.

---

[1] J.S. Sundaram, *Consumer Protection in India* (Delhi, B.R. Publishing Corporation, 1985), p.1.

This does not, however, mean that consumerism is necessarily a problem for the business. Consumerism is, in fact, regarded as an opportunity by consumer oriented businessmen, as described later in this chapter.

Consumer Rights

Consumers in the advanced countries, obviously, are much more conscious of their rights than in countries like India. In 1962 President John F. Kennedy, and in 1965 President Jhonson emphasised the consumer rights and gave an impetus to consumerism in the U.S.A. and other countries.

Important consumer rights include:

(i) right against exploitation by unfair trade practices;

(ii) right to protection of health and safety from the goods and services the consumers buy or are offered free;

(iii) right to be informed of the quality and performance standards, ingredients of the product, operational requirements, freshness of the product, possible adverse side effects and other relevant facts concerning the product or service;

(iv) right to be heard if there is any grievance or suggestions;

(v) right to get the grievances redressed;

(vi) right to choose the best from a variety of offers;

(vii) right to a physical environment that will protect and enhance the quality of life.

The Consumer Protection Act, 1986, has listed the consumer rights it seeks to protect in India. Details of the Act are given at the end of the Chapter.

Exploitation of Consumers

Consumers are, however, by and large, practically denied most of these rights. They are exploited by a large number of restrictive and unfair trade practices. It has been reported that, over the past half a century, the Federal Trade Commission of the U.S.A. has labelled under the Federal Trade Commission Act, 1914, numerous practices not known before. A situation has developed in which the public have become victims of false claims for products blatantly advertised, even though they may not have an adverse effect on the competition.

Behavioural science is extensively applied to marketing to ruthlessly exploit the consumers by stimulating the weak points and soft corners of their mind. Misleading, false or deceptive advertisements are quite common. Many a time the advertisements deliberately give only half truths so as to give a different impression than is the actual fact. Thus, advertisements may be misleading because things that should be said have not been said, or because advertisements are composed or purposefully printed in such a way as to mislead. The situation is such that misrepresentations about the quality of a commodity or the potency of a drug or medicine can be projected without much risk.

As the High-Powered Expert Committee on Companies and MRTP Acts, Popularly known as the Sachar Committee, points out, fictitious bargains are another common form of deception. Many devices are used to lure buyers into believing that they are getting something for nothing or at a nominal value for their money. Prices may be advertised as generally reduced and cut when in reality the goods may be sold at sellers' regular prices.

Thus, apart from the monopolistic and restrictive trade practices that have the effect of restricting competition and increasing the market imperfections to the common detriment, consumer exploitation through unfair trade practices that mislead or dupe the customers has become widespread. And it is this situation that has largely led to the growth of consumerism.

Consumerism

Philip Kotler defines Consumerism as "a social movement seeking to augment the rights and powers of the buyers in relation to sellers".[2] Harper W. Boyd, Jr., and David E. Allen, Jr., state that "although often abused as a term, consumerism maybe best defined as the dedication of those activities of both public and private organisations which are designed to protect individuals from practices that impinge upon their rights as consumers".[3]

In his speech delivered at the 44th Annual General Meeting of *Hindustan Lever Ltd.* in 1977, the Chairman, Mr. T. Thomas, rightly pointed out: "While the producer has the power or the right to design the product, distribute, advertise and price it, the consumer has only the power of not buying it. One may argue that the producer runs the greater risk in spite of having several rights because the veto power remains with the consumer. However, the consumer often feels that while he has the power of veto, he is not always fully equipped to exercise that power in his best interests. This situation may be the effect of lack of information, too much indigestible information or even misinformation from one or several competing producers. This problem facing the consumer has led to 'consumerism'. It is worthwhile to note that consumerism, like several other social movements, e.g., independence movement, Civil Rights movement, etc., has been the result of a social conflict and cannot, therefore, be wished away. It will be with us till the conflict facing the consumer is resolved".

---

[2] Philip Kotler, "What Consumerism Means for Markets", in *Harvard Business Review*, May-June 1972, p. 49.

[3] Harper, W. Boyd, Jr., and David, E. Allen, Jr., "Caveat Emptor, Caveat Venditor, Caveat Omnis" in Neelamegham, S. (ed.), *Marketing Management and the Indian Economy* (New Delhi: Vikas Publishing House Pvt. Ltd., 1982), p. 310.

Consumerism, interpreted as a collective endeavour of the consumers to protect their interests, is a manifestation of the failure of the business, including that of the public sector, and the government to guarantee and ensure the legitimate rights of the consumers.

Consumer Protection

For effective consumer protection, a practical response on the part of three parties, viz., the business, the government and the consumers, is essential. *Firstly*, the business, comprising the producers and all the elements of the distribution channels, has to pay due regard to consumer rights. The producer has an inescapable responsibility to ensure efficiency in production and the quality of output. He should also resist the temptation to charge exorbitant prices in a seller's market.

Many a time, the imperfections on the supply side, like hoarding and blackmarketing, mercilessly gouge the consumer. Hence, a socially responsible producer should see to it that whatever is produced reaches the ultimate consumer in time and at reasonable prices.

As the veteran business executive, Mr. T. Thomas observes: "Restraint is best exercised voluntarily than through legislation which will otherwise become inevitable. Advertising agencies and marketing management have a very important role to play in this respect. By overplaying the claims, they will be cutting the very branch on which they are perched".[4]

Secondly, the Government has to come to the rescue of the helpless consumer to prevent him from being mislead, duped, cheated and exploited. The motive of private gain tempts business to maximise income by socially undesirable trade practices; and this calls for government intervention.

Statutory action to protect the interests of consumers has become quite common. In the United Kingdom, for instance, the Trade Description Act, 1968, prohibits the use of misleading descriptions of goods or services or misleading representation of price reductions. In a number of countries, pro-consumer legislation contains provisions that enable an affected party to seek remedy for compensation for the loss or damage suffered by it at the hands of a person who has indulged in prohibited practices. This is true of the Sherman Act and the Clayton Act of the U.S.A.; the Federal Act of Switzerland, the Act Against Restraint of Competition of Spain, the Act concerning Prohibition of Private Monopoly and Maintenance of Fair Trade of Japan, the Trade Practices Act of Australia, the Combines Investigation Act of Canada, etc.

In some countries, statutory bodies are empowered to require the advertiser to substantiate the claims made in the advertisements. For in-

---

[4] From the speech delivered at the 44th Annual General Meeting of *Hindustan Lever Ltd.* in 1977.

stance, the Federal Trade Commission (FTC) of the United States can seek *affirmative disclosures*. That is, if information in an advertisement is considered insufficient by the FTC, the Commission may require a company to disclose in its advertising some of the deficiencies or limitations of its product or service so that the consumer can judge its negative, as well as, positive attributes. The FTC can also require the advertisers to submit on demand by the Commission data to back-up advertising claims for a product's safety, performance, quality or price comparability. The intent of this *substantiation* is to help consumers make more reasoned choices by having information made available to them. Members of many industry groups, including automobiles, appliances, soaps and detergents, television sets, dentistries, hearing aids, and all over-the-counter drugs have been ordered to provide the Commission with documentation in support of their designated advertising claims. *Corrective advertising* requirements have increasingly been a part of many FTC consent orders. Corrective advertising doctrines are based upon the idea that inaccurate information has already been communicated by advertisers, and that corrective advertising is needed to eliminate the lingering effects of such information.[5]

Thirdly, consumers should accept consumerism as a means of asserting and enjoying their rights. Consumerism should succeed in making the business and the government more responsive to the rights of the consumers. *Consumerism is a social force to (i) make the business more honest, efficient, responsive and responsible, and (ii) pressurise the government to adopt the necessary measures to protect consumer interests by guaranteeing their legitimate rights.*

Peter F. Drucker, the well-known writer on Management Science, has pointed out that "consumerism is the shame of the total marketing concept,"[6] implying that the concept is not widely implemented. Consumerism reflects not only the failure of the business to widely implement the marketing concept but also the need to give the business policies a social orientation so as to enhance long-run social welfare. As Philip Kotler observes, "Consumerism is a clarion call for a *revised marketing concept*".[7] Hence, the original marketing concept has to be broadened to include the societal marketing concept.

"The societal marketing concept calls for customer orientation backed by integrated marketing aimed at generating customer satisfaction and long-run consumer welfare as the key to attaining long-run profitable volume".[8]

---

[5] Rom J. Markin, *Marketing* (New York: John Wiley & Sons, 1979), pp.475-76.

[6] Cited in Philip Kotler, "What Consumersim means for Marketers," *op.cit.*, p. 54.

[7] Philip Kotler, *Ibid.*, p. 54.

[8] *Ibid.*, p.54

As Kotler points out, "the addition of long-run consumer welfare asks the businessman to include social and ecological considerations in his product and market planning. He is asked to do it not only to meet his social responsibilities but also because failure to do this may hurt his long-run interests as producer".[9] Thus, the message of consumerism is not a setback for marketing but rather points to the next stage in the evolution of enlightened marketing. Just as the sales concept said that sales were all important, and the original marketing concept said that consumer satisfaction was also important, the societal marketing concept has emerged to say that long-run consumer welfare is also important".[10] Hence, he feels that consumerism will be enduring, beneficial, pro-marketing and ultimately profitable. "Consumerism mobilises the energies of consumers, businessmen and government leaders to seek solutions to several complex problems in a technologically advanced society. One of these is the difference between serving consumer desires efficiently and serving their long-run interests. To marketers, it says that products and marketing practices must be found which combine short-run and long-run values for the consumer. It says that a societal marketing is an advance over the original marketing concept and a basis for earning increased consumer goodwill and profits. The enlightened marketer attempts to satisfy the consumer *and* hence his total well-being on the theory that what is good in the long-run for consumer is good for business".[11]

Utility of Consumerism

Well-organised and dynamic consumerism may be expected to produce the following results:

(i) Producers and sellers will not take the consumer for granted. When consumers are strong enough to protect their rights, the business will be compelled to shun unfair trade practices.

(ii) Consumerism will provide feedback for the business. It will enable the producers to understand consumer needs and wants. This will assist in the more effective implementation of the marketing concept or the societal marketing concept, depending upon the nature of consumerism.

(iii) Producers will be able to enlist the support of consumers to minimise the imperfections on the distribution front. Several times the supply position is made worse by hoarding and blackmarketing by traders. Further, many sellers have a tendency to charge a price which is higher than the actual by giving one or other reason. There is no reason why the consumer and producer should not co-operate to get rid of the unscrupulous traders.

---

[9] *Ibid.*, p. 55.

[10] *Ibid.*, p. 55.

[11] *Ibid.*, p. 57.

(The above points indicate that consumerism is an opportunity for honest and dynamic business firms. In fact, quite a few leading businessmen view it so.)

(iv) Consumerism will make the government more responsive to consumer interests, prompt it to take necessary statutory measures, and make the required institutional arrangements to safeguard consumer rights.

CONSUMER PROTECTION AND CONSUMERISM IN INDIA

Plight of the Indian Consumer

An examination of the important problems facing the Indian consumer would make clear the need for more effective government intervention and consumer movement to safeguard consumer rights. The following factors make his plight miserable:

(i) Short supply of many goods and services, especially of essential items, is a very serious problem afflicting the Indian consumer. This demand-supply imbalance has produced all the associated evils of profiteering, hoarding and blackmarketing, corruption, nepotism, irresponsiveness and arrogance towards consumers.

(ii) The Indian consumer is also the victim of lack of *effective* or *workable competition*. "Competition among sellers, even though imperfect, may be regarded as effective or workable if it offers buyers real alternatives sufficient to enable them, by shifting their purchases from one seller to another, substantially to influence quality, service, and price. Commodities, to be effective, need not involve the standardization of commodities; it does, however, require the ready substitution of one product for another; it may manifest itself in differences in quality and service as well as in price. Effective competition depends also upon the general availability of essential information; buyers cannot influence the behaviour of sellers unless alternatives are known. It requires the presence in the market of several sellers, each of them possessing the capacity to survive and grow, and the preservation of conditions which keep alive the threat of potential competition from others. It cannot be expected to obtain in fields where sellers are so few in number, capital requirements so large, and the pressure of fixed charges so strong, that price warfare, or the threat of it, will lead almost inevitably to collusive understandings among the members of the trade. Effective competition requires substantial independence of action; each seller must be free to adopt his own policy governing production and price; each must be able and willing constantly to reconsider his policy and to modify it in the light of changing conditions of demand and supply. The test of effectiveness and workability in competition among sellers is thus to be found in the availability of buyers of genuine alternatives in policy among their sources of supply".[12]

---

[12] Joel Dean, *Managerial Economics* (New Delhi : Prentice-Hall of India Pvt. Ltd., 1978), pp. 55-56.

(The above two points should not be confused as one and the same. Short supply refers to quantitative insufficiency whereas lack of effective competition refers to dearth of alternatives.)

(iii) Many products with which consumers in advanced countries are quite familiar are still new to a very large segment of the Indian consumers. The unfamiliarity of the consumers with product features makes the sale of substandard, inferior or even defective products easier in India than in advanced countries.

(iv) Due to low literacy levels and unsatisfactory information flows, the Indian consumers, by and large, are not conscious of all their rights. This encourages irresponsible and unscrupulous business attitudes and tactics.

(v) It has been said that the legal process in India is comparatively time-consuming and cumbersome. This discourages the consumers from seeking the redressal of their grievance by means of the judicial process.

(vi) Consumerism in India is not well organised and developed.

(vii) Though the public sector has been developed and expanded to serve the public interest by providing effective competition to the private sector, increasing production, improving distribution, etc., it has yet to produce benefits that are commensurate with the investment. It is an irony that though consumer welfare is an avowed objective of the public sector, in certain areas the poor performance of the public sector monopolies has made the plight of the consumer more miserable. Some of them are even charged with unfair trade practices. For instance, electricity consumers are compelled to pay service charges for the service they never or hardly receive. Such is the plight of the telephone consumers also. In State-owned road transport corporations, it is common that passengers who have paid fares for luxury or express services are compelled to travel in ordinary coaches.

(viii) Though there are a number of laws to safeguard the interests of consumers, they are not effectively implemented and enforced to achieve the objectives.

The above factors call for effective State intervention and consumerism to ensure the rights of consumers.

Government Measures

In India, the Government has taken a number of measures to protect consumer interests. The various Government measures may be classified into (i) statutory regulation of private business, and (ii) development and expansion of the public sector.

Statutory Regulation: Government of India has armed itself with a number of statutory weapons to control the production, supply, distribution, price and quality of a large number of goods and services. It is empowered to regulate the terms and conditions of sale, the nature of trade and commerce, etc. There is a feeling that, "unlike in the West, the Government in India has a large number of controls on industry and is, therefore, in a position to respond more swiftly and effectively than Western Governments. In some ways our bureaucracy has perfected the art of assuming the guardianship of all interests of the consumers and the vulnerable sections".[13]

Important legislations in this respect includes the MRTP Act, Industries Development and Regulation Act, Essential Commodities Act, Prevention of Food Adulteration Act, Prevention of Blackmarketing and Maintenance of Supplies of Essential Commodities Act, Trade Marks and Merchandise Marks Act, Sale of Goods Act, Indian Patents and Designs Act, Agricultural Products Grading and Marketing Act, Drugs Act and Drugs Control Act, Indian Standard Institute's Certification Act, Standard Weights and Measures Act, Imports and Exports Control Act, Packaged Commodities Order, Price and Stock Display Order, Consumer Protection Act etc.

There are, thus, a good number of laws to protect consumer interests. But a common complaint is that these laws are not effectively implemented.

The Monopolies and Restrictive Trade Practices Act, 1969, contains provisions to deal with monopolistic and restrictive trade practices that are prejudicial to public interest.[14] One of the significant aspects of the MRTP (Amendment) Act of 1984 is the incorporation of provisions to control unfair trade practices. (For details, see the chapter on MRTP Act.)

Growth and Expansion of Public Sector: There have been a significant growth and expansion of the public sector in India. One of the most important objectives of the public sector is the enhancement of consumer welfare by increasing production, improving efficiency in production and supply, making available goods and services at fair prices, curbing private monopolies and reducing market imperfections, improving the distribution system, and so on. The public sector, in fact, is expected to implement the societal marketing concept.

There is, however, a general feeling that the public sector in India has still a long way to go to realise these objectives. It has established monopolies or near-monopolies in public utilities, whose performance is far from satisfactory. There is a widespread impression that the monopolisation of public transport by the public sector has only aggravated the problems of the common man. Denationalisation of road transport or allowing the private sector also to operate will help to reduce the sufferings of the public.

---

[13] From the Chairman's Speech at the 44th Annual General Meeting of *Hindustan Lever Ltd.*, in 1977.

[14] For details see chapter on the MRTP Act.

The irony, further, is that certain laws like the MRTP Act are not applicable to the public sector. As the Sachar Committee has observed: "There is no justification for exempting Government and Government-controlled/owned undertakings from the provisions relating to control and prohibition of monopolistic and restrictive trade practices and the..... provisions relating to unfair trade practices ..... The beneficiary of monopoly legislation is the consumer and it is only fair and reasonable that undertakings owned or controlled by the Government should be subject to the same type of rigour and discipline as the private sector undertakings where the interests of consumers are involved".[15]

The Government has developed the public distribution system[16] to reduce the hardships of consumers, especially of the vulnerable sections, by making essential consumer goods available more equitably and at fair prices. There is, however, a common complaint that some of the items, especially the foodgrains supplied by the system, are of inferior quality.

Consumerism

It may be said that there is no consumerism worth the name in India. True, there have been occasional mass consumer demonstrations against market imperfections, mainly shortages and exorbitant prices. But several of these demonstrations have been organised with vested political interests and consumer involvement and dedication have been limited. Of course, a number of consumer organisations have been formed in different parts of the country. But with the exception of a very few, they have yet to demonstrate their practical utility. Further, whatever little organised consumer movement there is in India is almost confined to urban areas, leaving the large majority of the Indian consumers high and dry.

A well developed consumerism is essential for the protection of consumer rights. Consumerism has the following important roles to play:

(i) *Consumer Education:* The consumer is given information about various consumer goods and services. This relates to prices, what the consumer can expect, standard trade practices, etc.[17]

(ii) *Product Rating*: In order to guide the consumer in his choice of products, some of the agencies carry out tests and submit reports on them.[18]

(iii) *Liaison with Government and with Producers:* Another important role of consumer organisations is to maintain liaison with producers on the one hand and Government authorities on the other. As Government is the key factor in meeting most consumer needs in India, these factor in meeting most consumer needs in India, these organisations have to realise that they have a larger role in that direction, especially in India.[19]

---

[15] *Ibid.*, p. 288.

[16] For details, see chapter on Price and Distribution Controls.

[17] From the speech of Mr. T. Thomas, Chairman, *Hindustan Lever Ltd.*, at the 44th Annual Meeting of the Company, 1977.

[18] *Ibid.*

Opportunity for Industry

Mr. Thomas argues that consumerism in India has not developed as a social reaction against overselling by industry, as happened in the West. On the contrary, it has been more a reaction to the evil effects of shortages and inflation. Therefore, the industry in India has a unique opportunity to respond to consumerism in a positive manner as outlined below[20]:

(i) First of all, marketing must be recognised and practised as something more than sales and distribution. It has to be considered as the Company's relationship with the consumer. In the wider context, it can be extended to become a part of the organisation's total responsibility to society. When we talk of the social responsibility of industry, one of its prime social responsibilities is to the consumer through the adoption of sound marketing methods.

(ii) Yet we cannot be complacent even with good marketing because it is not possible that many manufacturers, including large ones, will always ask all the questions that are relevant to the consumer, particularly with regard to product safety, comparative cost effectiveness, etc. Consumer movements tend to focus on such questions and may well be seen as an extension of the marketing role. Therefore industry should co-operate with consumer movements in terms of information on, and education in, the products. Conversely, such information may also educate the consumer in the issues facing the producers, viz., cost of capital, norms of profitability, impact of Government policies, etc.

(iii) Industry will have to invest increasingly in testing the safety of the products in use. It is far better to organise for this than to wait for nasty accidents which will make it all mandatory and exaggerated.

(iv) Dealing with consumer complaints satisfactorily is yet another responsibility of the industry. Promptness, courtesy and generosity are expected by the consumer with a genuine complaint. Apart from the loss and irritation caused to the consumer, persistent complaints, even if small in number, are often a good indicator of a necessary improvement.

---

[19] *Ibid.*

[20] *Ibid.*

(v) Another important role, of this industry is in relation to claims made on behalf of the products through advertising. Restraint is best exercised voluntarily than through legislation which will otherwise become inevitable. Advertising agencies and marketing managements have a very important role to play in this respect. By overplaying the claims, they will cut the very branch on which they are perched.

(vi) Lastly, if industry has to continue to cope with consumerism, it has to invest in R & D because consumer expectations and needs are constantly rising and the constraints on meeting them are changing. To cope with this effectively, industry has to find solution through R & D. It is when consumer needs exceed the industry's ability to meet them that consumerism tends to become menacing. With adequate anticipation by industry, such a situation need not arise.

The above facts indicate that co-operative efforts on the part of consumers, business and the Government are very necessary to protect the rights of the consumers. A well-organised consumerism is needed to make the Government responsive and effective and the business responsible and obliging. To sincere and dynamic business enterprises, consumerism does not pose a threat but offer an opportunity.

THE CONSUMER PROTECTION ACT, 1986

An important landmark in the history of consumer protection legislation in India is the Consumer Protection Act, 1986, which provides for a system for the protection of consumer rights and the redressal of consumer disputes.

This Act extends to the whole of India except the State of Jammu and Kashmir and save as otherwise expressly provided by the Central Government by notification, it applies to all goods and services.

The objective of the Act is to provide for the better protection of the interests of consumers and for that purpose to make provision for the establishment of consumer councils and authorities for the settlement of consumers' disputes and for matters connected therewith.

Consumer Protection Councils

The Act provides for the establishment of a Central Consumer Protection Council by the Central Government and a State Consumer Protection Council in each State by the respective State governments.

The Central Council shall consist of the Minister in charge of the Department of Food and Civil Supplies in the Central Government who shall be its Chairman and such number of other official or non-official members representing such interests as may be prescribed and the Council shall meet as and when necessary but not less than three meetings of the Council shall be held every year.

The State Council shall consist of such members as may be specified by the State Government by notification from time to time.

The objects of the Central Council are to promote and protect the rights of the consumers such as :

(a) the right to be protected against marketing of goods which are hazardous to life and property;

(b) the right to be informed about the quality, quantity, potency, purity, standard and price of goods so as to protect the consumer against unfair trade practices;

(c) the right to be assured, wherever possible, access to a variety of goods at competitive prices;

(d) the right to be heard and assured that consumers' interests will receive due consideration at appropriate forums;

(e) the right to seek redressal against unfair trade practices or unscrupulous exploitation of consumers; and

(f) the right to consumer education.

The objects of every State Council are to protect within the State the rights of the consumers listed above.

Consumer Disputes Redressal Agencies

The Consumer Protection Act provides for a three-tier consumer disputes redressal system encompassing the district, State and national levels. There are two levels of agencies in the State and one agency at the national level. In other words, the Act provides for the establishment of the following consumer disputes redressal agencies:

(i) A *District Forum* in each district of every State;

(ii) A *State Commission* in each state; and

(iii) A *National Commission.*

The National Commission was established by the Central Government in August 1988. The responsibility for the establishment of the other two agencies, with the prior approval of the Central Government, rests with the respective State Government.

The District Forum shall consist of (a) a person who is, or has been, or is qualified to be a District Judge nominated by the State Government who shall be its President, (b) a person of eminence in the field of education, trade or commerce, and (c) a lady social worker.

Each State Commission shall consist of a person who is or has been a judge of a High Court, appointed by the State Government (who shall be its President) and two other members who shall be persons of ability, integrity and standing and have adequate knowledge or experience of or have shown capacity in dealing with problems relating to economics, law, commerce, accountancy, industry, public affairs or administration, one of whom shall be a woman.

The National Commission shall consist of a person who is or who has been a judge of the Supreme Court, appointed by the Central Government (who shall be its President) and two other members who shall be persons of ability, integrity and standing and have adequate knowledge or experience of or have shown capacity in dealing with problems relating to economics, law, commerce, accountancy, industry, public affairs or administration, one of whom shall be a woman.

A complaint where the value of the goods or services and the compensation, if any, is less than rupees one lakh is to be dealt with the District Forum; where such value exceeds rupees one lakh but does not exceed rupees ten lakhs it is to be dealt with the State Commission and cases involving more than rupees ten lakhs fall within the jurisdiction of the National Commission.*

The State Commission will also entertain appeals against the orders of any District Forum within the State. Appeals against the orders of the State Commission can be made to the National Commission. Appeals against the orders of the National Commission can be made to the Supreme Court.

The State Commission is further empowered to call for the records and pass appropriate orders in any consumer dispute which is pending before or has been decided by any District Forum within the State, where it appears to the State Commission that such District Forum has exercised a jurisdiction not vested in it by law, or has failed to exercise a jurisdiction so vested or has acted in exercise of its jurisdiction illegally or with material irregularity. The National Commission has similar jurisdiction over the State Commissions.

A complaint, in relation to any goods sold or delivered or any service provided may be filed with a District Forum or State Commission, as the case may be, by -

(a) the consumer to whom such goods are sold or delivered or such service provided;

(b) any recognised consumer association, whether the agrieved consumer is a member of such association or not; or

(c) the Central or State Government.

Remedial Action

If any of the consumer disputes redressal agencies is satisfied that any of the allegations contained in the complaint is true, it shall issue an order to the opposite party directing him to take one or more of the following things, namely:

---

* The address of the National Commission is: National Consumer Protection Council, Theenmurthy Marg, New Delhi-110 011.

(i) to remove the defect pointed out by the appropriate laboratory from the goods in question;

(ii) to replace the goods with new goods of similar description which shall be free from all defects;

(iii) to return to the complainant the price, or, as the case may be, the charges paid by the complainant;

(iv) to pay such amount as may be awarded by it as compensation to the consumer for any loss or injury suffered by the consumer due to the negligence of the opposite party.

If a trader or person against whom a complaint is made fails or omits to comply with any order made by a redressal agency, he shall be punishable with imprisonment for any term not exceeding three years or with fine not exceeding ten thousand rupees or with both.

One redeeming feature of the Consumer Protection Act is that it applies not only to the private sector but also to the public sector and government agencies. As against this, it may be noted that, the undertakings in the public and cooperative sectors and those undertakings the management of which has been taken over by the Government are exempted even from the provisions dealing with *unfair trade practices* under the MRTP Act.

Amendments to the Consumer Protection Act

Some progressive amendments to the Consumer Protection Act were introduced by the Consumer Protection (Amendment) Ordinance, 1993. Salient features of the amendment are given below:

(i) The pecuniary jurisdiction of the District Forum was raised from Rs. 1 lakh to Rs. 5 lakhs and that of State Commission from Rs. 10 lakhs to Rs. 20 lakhs.

(ii) State governments are empowered to establish more than one District Forum in a district if it deems fit in large cities.

The raising of the pecuniary jurisdiction will increase the workload of District Forums as most of consumer complaints do not exceed Rs. 5 lakhs in value. Hence, it would be in the consumers' interest that the State governments establish more than one Forum in districts with large cities.

(iii) Now an agrieved party can institute a complaint at any place were branch office of the opposite party of an establishment is situated.

(iv) Right is granted to one or more consumers to institute a complaint where there are several consumers having the same interest.

(v) The definition of Unfair Trade Practice (UTP) has been incorporated at length in the Act thereby dispensing with the need to refer to the MRTP Act for definition of UTP.

(vi) Use by consumer of goods bought and used by him exclusively for the purpose of earning livelihood in cases of self employment is excluded from the definition of commercial purpose.

(vii) Housing construction has been included within the definition of services.

(viii) The Fora have been given additional authority and power. The Fora can issue an order to the opposite party directing him to remove defect or deficiency in the services in question; to discontinue to the UTP or Restrictive Trade Practice (RTP) or not to repeat them; not to offer hazardous goods for sale; and to provide for adequate costs to parties.

The Ordinance has thus removed several deficiencies of Act.

6

Economic Systems

The scope of private business and the extent of government regulation of economic activities depend to a very large extent on the nature of the economic system, which is an important part of the business environment. This chapter is intended to provide an outline of the general features of the broadly distinctive economic systems.

CAPITALISM

"The capitalist system is one characterised by the private ownership of the means of production, individual decisionmaking, and the use of the market mechanism to carry out the decision of individual participants and facilitate the flow of goods and services in markets".[1]

"In a capitalist economy, households and firms are the basic production units. Each individual household is the owner of productive factors. These factors include the household's own labour and may also include land, capital and raw materials. Each household sells the services of its factors to the basic production unit, the firm. Private firms, organised by individuals, combine these productive factors to produce goods. The difference between revenues and costs constitutes profits, which then form the income of the firm's organizers. The income earned from the sale of a household's productive factors enables it to purchase the finished products of the firms".[2]

The capitalist system is also known as *free enterprise economy* and *market economy*.

Two types of capitalism may be distinguished, viz.,

(i) The old, *laissez-fair* capitalism, where government intervention in the economy is absent or negligible; and

---

[1] Gary M. Pickersgill and Joyce E. Pickersgill, *Contemporary Economic Systems : A Comparative View* (New Jersey : Prentice-Hall of India Inc., 1974), p. 13.

[2] *Ibid.*, p. 13.

(ii) The modern, *regulated* or *mixed* capitalism, where there is a substantial amount of government intervention.

Features

The principal characteristics of a "pure" capitalist system are:

(i) Private Ownership: In a capitalist economy, the factors of production—land, labour and capital — are privately owned, and production occurs at private initiative. Individuals have their property rights protected and are usually free to use their property as they like as long as they do not infringe on the legal property rights of others. Private property, however, is protected, controlled and enforced by law.

(ii) Free Enterprise: Free enterprise, an essential feature of the capitalist system, is merely an extension of the concept of property rights. The term *free enterprise* implies that private firms are allowed to obtain resources, to organise production and to sell the resultant product in any way they choose. In other words, there will not be any government or other artificial restrictions on the freedom and ability of the private individuals to carry out any business.

(iii) Consumers' Sovereignty: Consumers' sovereignty is at its best in the capitalist system where consumers have complete freedom of choice of consumption. The production decisions in the free market economy are based on the consumer desires which are reflected in the demand pattern. Frederic Benham remarks: "Under capitalism, the consumer is the king".

(iv) Freedom of Choice of Occupation : In a capitalist economy, the individual is free to choose any occupation he is qualified for. This freedom of choice enables the worker to make the best possible bargain for his labour. This implies that the employers have to competitively bid for labour. Freedom of occupational choice, however, does not mean guarantee of the job a worker opts for; the choice is practically limited by the extent of availability of the jobs.

(v) Freedom to Save and Invest: The freedom to save is implied in the freedom of consumption, for savings depend on income and consumption. The term *saving* implies the sacrifice of consumption. As George Halm observes: "The right to save is supported by the right to transmit wealth, so that the choice between present and future consumption is not limited to the adult life of one person. The freedom to save, inherit, and accumulate wealth is, therefore, a right which is perhaps more typical for the private enterprise system than is free choice of consumption and occupation". [3]

(vi) The Market System: The *market mechanism* is the key factor that regulates the capitalist economy. A market economy is one in which buyers

---

[3] George N. Halm, *Economic System : An Adaptation* (New York:Peffer and Simons, 1971), p. 32.

and sellers express their opinions about how much they are willing to pay for or how much they demand of goods and services. Prices guide the purchase decisions of the consumers. At the same time, while they decide to buy or not to buy a product, consumers vote for or against the product by using their money. Thus, market prices, which reflect the desires of millions of consumers, provide guidance to investors and other business persons. The market system, also called the *price system*, may, therefore, be regarded as the organising force in a capitalist economy.

(vii) Competition: Competition among sellers and buyers is an essential feature of an ideal capitalist system. Competition reduces market imperfections and associated problems. Therefore, in a free market economy, "a sufficient amount of competition is considered necessary if the whole production and distribution process is to be regulated by market forces. Competition is necessary in a private enterprise economy to keep initiative constantly on alert, to protect the consumer, and to maintain a sufficiently flexible price system".[4]

(viii) Absence of a Central Plan: As is clear from the features mentioned above, the capitalist system is essentially characterised by the absence of a central plan. That is, the activities of the numerous economic units in a capitalist system are not guided, co-ordinated or controlled by a central plan. Freedom of enterprise, occupation and property rights rule out the possibility of a central plan. Resource allocation and investment decisions in a free market economy are influenced by *market forces* rather than by the State.

(ix) Limited Role of Government: The absence of a central plan does not mean that the Government does not play any role in a private enterprise economy. Indeed, Government intervention is necessary to ensure some of the essential features and smooth functioning of the capitalist system. For example, Government interference is necessary to define and protect property rights, ensure freedom of entry and exit, enforce contractual agreements among private entrepreneurs, ensure the satisfaction of certain community wants, etc. However, Government interference in the system is comparatively very limited.

The *pure* capitalist system which has been described above is a highly idealised system. There is hardly any pure capitalist or free enterprise system in the real world today. The capitalist economies of today are characterised by State regulation in varying degrees.

Modern Capitalism

Modern capitalist economies are *mixed* or regulated systems. Such regulated capitalist or market economies include the United States, Canada, Australia, the United Kingdom, France, Italy, the Federal Republic

---

[4] *Ibid.*, pp. 32-33.

of Germany (West Germany), Japan, Spain, New Zealand, the Netherlands, Belgium, Denmark, Sweden, Switzerland, Norway, etc. The principal reasons for Government intervention in the modern capitalist economies have been mentioned in the chapter 6, *Economic Roles of Government.*

Evaluation of Capitalism

Pure capitalism is an idealised system. It is very difficult to realise the avowed virtues of a free enterprise economy in the real world. There is no *invisible hand* that ensures the smooth functioning of the capitalist system.

Unregulated capitalism suffers from certain drawbacks.

(i) As investment allocation is guided by the profitability criterion, sufficient investment may not take place in areas where profitability is low, however essential they may be. Profitability would be generally high in sectors which cater to the needs of the upper income strata. A large part of the resources of the nation may, therefore, be utilised for the satisfaction of the needs of the well-to-do. Resource allocation under pure capitalism will not, therefore, be optimal.

(ii) The right to property and freedom of enterprise are likely to lead to concentration of income and wealth and the widening of inter-personal income disparities.

(iii) Though, according to the theory, there will be free competition, in the real world the large firms are likely to gain an advantageous position which would eventually lead to monopolies.

Because of these defects of pure capitalism, modern capitalist economies are *regulated* systems. In such regulated capitalist economies, not only does the state regulate private enterprise but often sets up enterprises either to supplement the activities of private enterprise or to offer an effective competition to the private sector. There may even be State monopolies in certain sectors. The modern capitalist economies, which are indeed *mixed* economies regulated by the State, are regarded as ideal systems by many people because they combine the positive aspects of the free enterprise system and State participation and regulation.

SOCIALISM

Within the wide spectrum of socialism, there is indeed a variety of systems. At one end there are the communist countries characterised by State capitalism, and at the other, there are the democratic socialist nations with a dominant private sector. It is , therefore, very difficult to clearly define the socialist system. Socialism, however, is generally understood as an economic system where the means of production are either owned or controlled by the state and where the resource allocation, investment pattern, consumption, income distribution, etc., are directed and regulated by the state.

Features

The salient features of a socialist system are:

(i) Government Ownership/Control: In socialist countries, the major means of production are either owned by the Government or their use is controlled by the Government. In communist countries like the USSR and China, the means of production are mostly owned by the State. In some socialist economies, the private sector also plays a very important role. In such cases, the Government directs and regulates investment allocation and production pattern in accordance with national priorities. In some countries, such as India, some of the basic sectors, including a major part of institutional finance, are in the public sector so that the resource allocation and investment pattern of the private sector may be regulated by regulating the flow of the basic inputs to the private sector. When the state owns almost the whole of the means of production, it is much more easy to achieve the desired pattern of resource allocation. *State capitalism,* of course, has its own defects. Communist countries like China have now wide opened their doors to foreign private capitalists to foster development.

(ii) Central Authority: The socialist economies generally have a central authority like the central planning agency to formulate the national plan for development and to direct resource mobilisation, allocation and investment to achieve the plan targets. Socialist economies are sometimes called *command economies* because the central planning authority commands the pattern of resource utilisation and development. They are also called centrally *planned economies*. Centrally planned economies include the USSR, China, the German Democratic Republic (East Germany), Poland, Romania, etc.

(iii) Restriction on Consumption: In communist countries, there is no consumer sovereignty because the state decides what may be made available to consumers, unlike in the market economies where the consumers have the freedom to choose from a wide variety. The consumers in a communist system, thus, have to content themselves with what the state thinks is sufficient for them.

(iv) Restriction on Occupation: The freedom of occupation is absent or restricted in socialist countries. An individual may not have the freedom to choose any occupation he is qualified for. Similarly, individual freedom of enterprise is absent or regulated.

(v) Fixation of Wages and Prices: The wage rates and prices in a communist economy are fixed by the Government and not by market forces. Non-communist socialist countries may also fix wages and prices or regulate them by certain means.

(vi) Distribution of Income: An equitable distribution of income is an important feature of the socialist system. This does not mean, however, that

socialist systems aim at perfect equality in income distribution. Wage differentials, depending on the nature and requirements of the job, are recognised in socialist countries. The objective of equitable income distribution may be achieved by fixing the wage rates and other economic rewards or by means of fiscal and other appropriate measures.

We have mentioned above the important theoretical features of socialism. In the real world, there is a variety of socialist systems; but all of them have one thing in common, namely, greater government control of the means of production than in the capitalist systems.

The traditional socialism emphasised government ownership of factors of production. But a number of today's socialist systems are based on government *control* of the means of production rather than pure state capitalism. Even the Euro-communism have a more liberal view than the Russian and Chinese systems. However, the Chinese and Russian systems are becoming some what liberal.

Socialist Command Economy

"The command economy is characterised by public ownership of the means of production, collective determination of economic decisions, and the allocation of resources by commands issued by the planning elite".[5] "The primary feature of the command economy is the centralisation of decision-making. There is no horizontal communication between producing and consuming units. All communication is vertical, i.e., between the individual economic unit and the planning agency".[6]

In a command economy, there is no individual freedom of choice of consumption and employment. The state determines what shall be produced in what quantities and by what methods. Similarly, the state determines the assortment and the amount of goods and services that may be consumed by individuals.

Just as there is no "pure" capitalist economy in the world, there is no pure command economy. However, some economies, like the Soviet economy, come near to this system, and they are generally regarded as command economies. However, as mentioned earlier, changes appear to have began.

Market Socialism

"Market socialism is characterised primarily by the public ownership of the means of production. Decisions with reference to the allocation of resources are made both collectively and by individual producing and consuming units. Prices and markets are the primary mechanisms used to facilitate the exchange of products".[7] The Yugoslav economy contains many of the elements of market socialism.

---

5. Jery M. Pickersgill and Joyce E. Pickersgill, *op. cit.*, p. 15.
6. *Ibid.*, p. 15.
7. *Ibid.*, p. 16.

Evaluation of Socialism

Socialism has become a very appealing and flexible concept. It has been aptly remarked that socialism is a cap that has lost its shape because so many different people have worn it. Indeed, there is a large variety of socialism today.

Democratic socialism strives to achieve a trade-off between the free enterprise system and state capitalism. Communism and state capitalism, however, suffer from a number of drawbacks. Some of the important among these are the following:

(i) Civil liberties are suppressed under communism. Under communism, man is a mere cog in the machine. If a free and fair election is conducted in the totalitarian countries, it is doubtful if people will vote for the status quo.

(ii) There is no consumer sovereignty in totalitarian systems. The state decides what and how much the people shall consume.

(iii) The central planning authority commands the resource allocation, investment and development pattern. But the views of the authority need not always be the right ones. As criticism is hardly tolerated, there is a limited scope for accommodating different views and making critical evaluations.

(iv) As private enterprise is not allowed to operate, the talents of the nation are not fully utilised.

(v) People may lack incentive to work hard in the absence of private property.

(vi) The absence of freedom of choice of occupation is undemocratic.

Because of the drawbacks of the totalitarian socialism mentioned above, a number of socialist systems today *are mixed* systems where we have both private enterprise regulated by the state and state enterprise. Liberal democratic socialism has its own merits; it strives to achieve the positive results of private enterprise, democratic rights and state regulation. As pointed out elsewhere, there has been a lot of liberalisation, recently, in the centrally planned economies; most of them are rapidly becoming market economy.

MIXED ECONOMY

The mixed economy, which shares certain features of private capitalism and state capitalism, is characterised by the co-existence of public and private sectors and the overall government regulation of the economy. "The primary difference between the mixed economy and market socialism is the relatively greater importance of individual decision-making, private property, and the reliance on market determined prices to guide the allocation of resources. The mixed economy differs from competitive capitalism with respect to the share of collective decision-making in the economy".[8]

In a mixed economic system, "there is wide latitude for government participation. The government may function as a mediator between conflicting economic groups as well as a consumer of the end-product of business and labour. Government may also attempt to guide the direction of the economy through the imposition of restrictions and grant of privileges to the private sector as well as by some form of planning".[9]

---

[8] Gary M. Pickersgill and Joyce E. Pickersgill, *op cit*, p. 16.

[9] *Ibid.*, p. 16.

7

Economic Roles of Government

The Government play an important role in almost every national economy of the world. Since the Great Depression of the 1930s, there has been a great appreciation of the role of government even in the capitalist economies. Dimock observes: "The two most powerful institutions in society today are business and government; where they meet on common ground-amicably or otherwise-together they determine public policy, both foreign and domestic, for a nation".[1]

Even in the countries described as capitalist economies or market economies, "a substantial share of the nation's product goes to satisfy public wants, a substantial part of the private income originates in the public budget and public tax and transfer payments significantly influence the state of private income distribution. Moreover, the budget policy affects the level of employment and prices in the private sector".[2]

In the predominantly private enterprise economies, government interference is necessitated by the fact, besides the socio-political ideological reasons, if any, "that the market mechanism alone cannot perform all economic functions. Public policy is needed to guide, correct and supplement it in certain respects. It is important to realize this fact since it implies that the proper size of the public sector is, to a significant degree, a technical rather than ideological issue".[3]

While the state control of economy is a universal phenomenon, the extent and nature of the control vary widely between nations depending upon the nature and stage of development of the economy, the behaviour of the private sector, the political philosophy, social attitudes administrative system etc.

---

1. Marshall E. Dimock, *Business and Government*, (New York: Holt, Rinehart and Winston Inc. 1961), p.1.
2. R. A. Musgrave, *The Theory of Public Finance*, (Tokyo: Kogakusha Ltd., 1959), p.3.
3. R. A. Musgrave and P. B. Musgrave, *Public Finance in Theory and Practice*, (Tokyo: McGraw-Hill Kogakusha Ltd., 1976), p.5.

Governments normally play four important roles in an economy, viz.,

(i) Regulation
(ii) Promotion
(iii) Entrepreneurship
(iv) Planning

As stated above, the extent and nature of these roles in a given situation depend on a number of factors. Some salient features of these roles are outlined below:

Regulatory Role: Government regulation of the business may cover a broad spectrum extending from entry into business to the final results of a business.

The reservation of industries to small scale, public and co-operative sectors, licensing system etc. regulate the entry. Regulations of product mix, promotional activities etc. amount to regulation of the conduct of business. Results of business operations may be regulated by such measures as ceilings on profit margins, dividend etc. The State may also regulate the relationship between enterprises. Examples of this include restrictions on intracorporate investments, interlocking of directors and on appointment of sole selling agents.

Government regulation of the economy may be broadly divided into:

(i) Direct controls; and
(ii) Indirect controls.

Indirect controls are usually exercised through various fiscal and monetary incentives and disincentives or penalties. Certain activities may be encouraged or discouraged through monetary and fiscal incentives and disincentives. For instance, a high import duty may discourage imports and fiscal and monetary incentives may encourage the development of export-oriented industries.

The direct administrative or physical controls are more drastic in their effect. The distinguishing characteristic of direct controls is their discretionary nature. They can be applied selectively from firm to firm and industry to industry, at the discretion of the State.

Direct controls have assumed increasing significance in many developing countries, including India. Their justifications are reasons that are economic, political and historical in nature; and in most countries, these reasons are often intertwined with one another. Most economic reasons are based on a variety of market failures, including imperfections and high-risk aversion on the part of private entrepreneurs.[4]

---

[4] World Bank, *State Intervention in the Industrialisation of Developing Countries: Selected Issues* (Washington: World Bank, July 1979), p.iii.

Many developing countries have instituted a variety of direct controls over the economy, including industrial licensing and price and distribution controls. As a World Bank *Staff Working Paper* points out, the major justification for the industrial licensing system is the belief that the market mechanism is unable to allocate the scare resources in a socially optimal way. The use of industrial licensing is, therefore, justified as the mechanism by which the state can control industrial investments and allocate resources to conform to pre-determined priorities and plan targets, if any. The common presumption, of course, is that the state is omniscient, and that the resulting allocation of resources will be socially optimal or socially desirable.

The other objectives of industrial controls include the prevention of the market structure from becoming monopolised, the development of small and new entrepreneurs, balanced regional development, etc.

Promotional Role: The promotional role played by the Government is very important in developed countries as well as in the developing countries. In the USA, "although on a comparative basis the function of assistance is less prominent than it used to be, it is still a large one. Thus, considering the whole of its activities, government does more to assist and to help develop industrial, labour, agricultural, and consumer interests than it does to regulate them. If this comes as a surprise, it is a measure of the degree to which we take for granted some of the most basic duties of the liberal government, and hence fail adequately to appreciate their value".[6]

In developing countries, where the infrastructural facilities for development are inadequate and entrepreneurial activities are scarce, the promotional role of the Government assumes special significance. The State will have to assume direct responsibility to build up and strengthen the necessary development infrastructures, such as power, transport, finance, marketing, institutions for training and guidance and other promotional activities.

The promotional role of the State also encompasses the provision of various fiscal, monetary and other incentives, including measures to cover certain risks, for the development of certain priority sectors and activities.

Entrepreneurial Role: In many economies, the State also plays the role of an entrepreneur - establishing and operating business enterprises and bearing the risks. A number of factors such as socio-political ideologies; dearth of private entrepreneurship; neglect of certain sectors, like the unprofitable sectors, by the private entrepreneurs; absence of or inadequate competition in certain segments and the resultant exploitation of consumers, etc. have contributed to the growth of State owned enterprises (SOEs) in many countries.

---

[5] *Ibid.*, p.75.

[6] Marshall E. Dimock, *op. cit.*, p.12.

As a World Bank Report points out, whereas some governments have an ideological preference for public control, others have travelled the same route for more pragmatic reasons. They may have wanted to rest control of key enterprises from foreign owners (Egypt in 1956 and Madagascar in 1974) or from minority ethnic groups (Uganda in the 1970s); in other instances, enterprises were inherited by the State after independence (Bangladesh in 1972) or a revolution (Portugal in 1974), or as a result of private sector bankrupticies. Governments have used nationalisation to capture the rents from the exploitation of minerals and where national security is involved (as in arms manufacture), to exercise direct military control. In other instances, Governments have decided to take the lead in starting a major new industry in the absence of private investors.[7] It is this last one which represents the true entrepreneurial role. The public sector in some countries like India have expanded also by taking over sick private units.

There was a tendency in many developing countries to assign a dominant place to the public sector. Public sector dominance was usually established in capital-intensive projects like steel, capital goods, petrochemicals and fertilizers for which investment requirements were very large and the expected private returns, at least in the short-run were too low to provide an incentive for private profitability. In many cases even when the private sector was prepared to undertake the risk and invest, State ownership of such industries existed for one reason or other.

However, recently many governments have resorted to privatisation in varying degrees, and have redefined the role of the public sector.

Planning Role: Especially in the developing countries, the State plays a very important role as a planner. The need for economic planning is very well implied in the famous 'scarcity definition' of Economics. As Robbins points out in his 'scarcity' definition, the main business of the science of Economics is the optimum allocation of the scarce resources between the competing ends.

The modern state is a custodian of the welfare of the society. The welfare government has the responsibility to fulfil the aspirations of the people by bringing about alround prosperity. The ends, i.e., the objectives to be achieved and the purpose to be served, are many. In the pursuit of this task, the most important problem especially in the case of the less developed countries, is the scarcity of resources. The resources that are readily available are quite in sufficient to meet all the ends. The resource constraints demand that some of the purposes should go unserved. This calls for the determination of the more urgent needs or national priorities and the optimal allocation of the available resources as best to subserve the common good. And this is the principal objective of national planning.

---

[7] World Bank, *World Development Report 1983*, (New Delhi: Oxford University Press, 1983), p.50.

The importance of planning to a less developed economy was often emphasised by Jawaharlal Nehru, the chief architect of Development Planning in India. He rightly observed: "whatever it may be in other countries, in under-developed countries like ours, which have to develop fairly rapidly, the time element is important and the question is how to use our resources to the best advantage. If our resources are abundant it will not matter how they are used. They will go into a common pool of development. But where one's resources are limited, one has to see that they are directed to the right purpose so as to help to build up whatever one is aiming at".[8]

ECONOMIC ROLES OF GOVERNMENT IN INDIA

The Constitutional Environment

The Indian Constitution incorporates a number of matters that are economically very significant and have far-reaching implications. The socio-economic and political objectives of the Indian Republic and the basic guiding principles of state functioning have been clearly laid down in the Preamble to the Constitution, in the Fundamental Rights and in the Directive Principles of State Policy. The Constitution also outlines the economic powers and responsibilities of the Union Government and the State Governments.

The economic responsibility bestowed on the state by the Indian Constitution is so enormous that it calls for great government interference in the functioning of the economy. In fact, a number of constitutional amendments, including the first amendment, were effected to enable the state to implement its economic policies and programmes.

The Preamble: The Preamble to the Indian Constitution states that, THE PEOPLE OF INDIA have solemnly resolved to constitute India into a SOVEREIGN SOCIALIST, SECULAR*, DEMOCRATIC REPUBLIC to secure to all its citizens:

JUSTICE, social, economic and political;

LIBERTY of thought, expression, belief, faith and worship;

EQUALITY of status and of opportunity;

and to promote among them all —

FRATERNITY assuring the dignity of the individual and the unity and integrity* of the Nation.

---

[8] Cited in "Jawaharlal Nehru on Nation Building," *Yojana*, 15 August, 1980, p.7.

* The words "Socialist Secular", and "and integrity" were inserted by the Constitution (42nd Amendment) Act, 1976.

The Preamble of a statute conveys the general object and intention of the legislature in enacting it. Although not an essential feature, whenever a Constitution contains a Preamble, it expresses the political, religious and socio-economic values which it envisages to promote. But, it does not control the meaning and scope of the other provisions of the Constitution. However, the Preamble may be a guide when the statute is vague. Otherwise, full effect should be given to the express words of the enactment.

The Preamble to the Constitution lays down that the attainment of social, economic and political *justice*, and *equality* of status and of opportunity should be among the most important basic guiding principles of the functioning of the state. As if this were not enough, the Constitution was amended in 1976 to add, among other things, that India should be a socialist state. In fact, as early as December 1954, the Indian Parliament had accepted the "socialist pattern of society" as the objective of social and economic policy. As if to give this objective more prominence, it was incorporated in the Preamble to the Constitution in 1976 under the controversial 42nd Amendment.

As the Preamble conveys the general object and intention of the Constitution and would be a guide in the interpretation of a statute when it is vague, the abovementioned aspects of the Preamble to the Constitution give some indications of the need and scope for state intervention in the functioning of the economy with a view to discharging its duties and responsibilities for the realisation of economic and associated objectives.

The Fundamental Rights: It has been claimed that the Indian Constitution offers all citizens, individually and collectively, the best fruits of democracy and those basic freedoms and conditions of life which alone make life significant and productive. The rights enumerated in Part III of the Constitution cover a wide range and are declared to be fundamental and justiciable.

The theory of fundamental rights implies limited government. It aims at preventing the government and the legislature from becoming totalitarian, and in doing so it affords the individual an opportunity for self-development. But these rights are not absolute; they are subject to limitations imposed by the state in order to secure rights for all individuals or to promote the greater interests of the community or the state, or to serve the ends of a planned society.

The Fundamental Rights enumerated in Part III of the Constitution are:

(a) Right to Equality;

(b) Right to Freedom;

(c) Right against Exploitation;

(d) Right to Freedom of Religion;

(e) Cultural and Educational Rights; and

(f) Right to Constitutional Remedies.

The Constitution had also guaranteed, under Article 19 (1) *(f)*, the Fundamental Right to Property; and Article 31 had prohibited the deprivation of property of any person save by authority of law; and for the deprivation of property compensation had been payable. But, in 1976, the 44th Amendment of the Constitution abolished the fundamental right to property by omitting Articles 19 (1) *(f)* and 31. However, Article 300 A of the new Chapter IV added to Part XII of the Constitution provides that "no person shall be deprived of his property save by authority of law". Thus, though the right to property is no longer a fundamental right, it has been retained as a Constitutional Right.

The Fundamental Rights also have economic significance.

The Right to Equality prohibits discrimination against any citizen on grounds of religion, race, caste, sex or place of birth. In public employment, it ensures equality of opportunity to all citizens. This is, however, subject to certain limitations, such as the right of the state to reserve posts for backward classes which, in the opinion of the state, are not adequately represented in the services.

The Constitution guarantees the citizens the fundamental right to freedom to practise any profession, carry on any occupation, trade or business. This right is subject to reasonable restrictions in the interest of the general public. Under the First Amendment to the Constitution (1951), the state is empowered to make laws relating to professional or technical qualifications necessary for practising any profession or carrying on any trade, business, industry or service, whether to the exclusion, complete or partial, of citizens or otherwise.

The Fundamental Right against Exploitation prohibits traffic in human beings, and beggary and other forms of forced labour; and any contravention of this provision shall be an offence punishable in accordance with the law. However, this does not prevent the state from imposing compulsory service for public purposes. In imposing such service, the state shall not make any discrimination on grounds only of religion, race, caste or class, or any of them.

Thus, the Fundamental Rights enumerated in the Constitution guarantee a number of economic rights to the citizens; but at the same time, the state has the power to impose reasonable restrictions on such rights in the public interest. A very important trend we may notice is that this power of the state to impose reasonable restrictions in the public interest has resulted in a remarkable increase in the statutory control over the business and a substantial expansion of the entrepreneurial or participative activities of the state. Consequently, there has been an abridgement of the economic liberty of the citizens embodied in Article 19 (1)(*g*).

The Directive Principles: The Directive Principles of State Policy is a unique feature of India's Constitution. The Directive Principles are in the nature of directions to the legislature and executive that they should exercise their authority in such a manner as to ensure due respect for, and observance of, these principles. Although these directives are not justiciable, the courts cannot altogether avoid taking cognisance of them. They are the imperative basis of state policy and the Constitution directs the state to apply these principles in making laws.

The Directive Principles that are economically very significant are quoted below:

(a) The State shall strive to promote the welfare of the people by securing and protecting as effectively as it may a social order in which justice, social, economic and political, shall inform all the institutions of the national life [Article 38(1)].

(b) The State shall in particular, strive to minimise the inequalities in income, and endeavour to eliminate inequalities in status, facilities and opportunities, not only among individuals but also amongst groups of people residing in different areas or engaged in different vocations [Article 38(2)].

(c) The State shall, in particular, direct its policy towards securing-

(i) That the citizens, men and women equally, have the right to an adequate means of livelihood;

(ii) That the ownership and control of the material resources of the community are so distributed as best to subserve the common good;

(iii) That the operation of the economic system does not result in the concentration of wealth and means of production to the common detriment;

(iv) That there is equal pay for equal work for both men and women;

(v) That the health and strength of workers, men and women, and the tender age of children are not abused and that citizens are not forced by economic necessity to enter a vocation unsuited to their age or strength; and

(vi) That children are given opportunities and facilities to develop in a healthy manner and in conditions of freedom and dignity and that childhood and youth are protected against exploitation and against moral and material abandonment (Article 39).

(d) The state shall ensure that the operation of the legal system promotes justice, on a basis of equal opportunity, and shall, in particular, provide for legal aid, by suitable legislation of schemes or in any other way, to ensure that opportunities for securing justice are not denied to any citizen by reason of economic or other disabilities (Article 39-A).

(e) The state shall take steps to organise village panchayats and endow them with such powers and authority as may be necessary to enable them to function as units of self-government (Article 40).

(f) The state shall, within the limits of its economic capacity and development, make effective provision for securing the right to work, to education and to public assistance in cases of unemployment, old age, sickness and disablement, and in other cases of undeserved want (Article 41).

(g) The state shall make provision for securing just and humane conditions of work and for maternity relief (Article 42).

(h) The state shall endeavour to secure, by suitable legislation or economic organisation or any other way, to all workers, agricultural, industrial or otherwise, a living wage, conditions of work ensuring a decent standard of life and full enjoyment of leisure and social and cultural opportunities and, in particular, the state shall endeavour to promote cottage industries on an individual or co-operative basis in rural areas (Article 43).

(i) The state shall take steps, by suitable legislation or in any other way, to secure the participation of workers in the management of undertakings, establishments or other organisations engaged in any industry (Article 43-A).

(j) The state shall promote with special care the educational and economic interests of the weaker sections of the people, and, in particular, of the scheduled castes and the scheduled tribes, and shall protect them from social injustice and all forms of exploitation (Article 46).

(k) The state shall regard the raising of the level of nutrition and the standard of living of its people and the improvement of public health as among its primary duties and, in particular, the state shall endeavour to bring about prohibition of the consumption, except for medicinal purposes of intoxicating drinks and of drugs which are injurious to health (Article 47).

(l) The state shall endeavour to organise agriculture and animal husbandry on modern and scientific lines and shall, in particular, take steps for preserving and improving the breeds, and prohibiting the slaughter of cows and calves and other milch and draught cattle (Article 48).

(m) The state shall endeavour to protect and improve the environment and to safeguard the forests and wild life of the country (Article 48-A).

These Directive Principles make quite clear how important is the economic responsibility bestowed on the state by the Constitution. Through constitutional amendments, new directives have been added to provide a greater socialist orientation to development. For instance, in 1978, by the 44th Amendment, a new clause was added to Article 38; and this new clause contains a directive to strive to minimise the inequalities in status, facilities and opportunities. The 42nd Amendment incorporated a new Article, 43-A, to direct the state to take suitable steps to secure workers' participation in management.

There have been many occasions when the Directive Principles and Fundamental Rights have been in conflict with each other. In the early days, the Supreme Court held that the Fundamental Rights were a sacrosanct part of the Constitution and nothing, including the Directive Principles, could override them. But the view that the Fundamental Rights should be subordinated to the Directive Principles gained ground in later years.

While asking the *Lok Sabha* to refer the Constitution (Fourth Amendment) Bill to the Select Committee, Prime Minister Nehru declared that the Fundamental Rights must subserve the Directive Principles. In the *Keshwanand Bharti vs. State of Kerala*, Justice Mathew observed that "in building up a just social order, it is sometimes imperative that the Fundamental Rights should be subordinated to Directive Principles... Economic goals have an uncontestable claim for priority over ideological ones on the ground that excellence comes only after existence. It is only if men existed that there can be fundamental rights."

The Directive Principles of State Policy enunciated in the Indian Constitution provide an enormous scope for Government intervention in the functioning of the economy.

Division of Power

India's Constitution distributes the items for legislation among three lists: (1) the Union List, (2) the State List, and (3) the Concurrent List. The respective jurisdictions of the Union and the States and their mutual relations have been clearly defined. The measures enacted by the Union under the Concurrent List ordinarily have priority over the corresponding State legislation.

Except for the Union Territories, the Centre cannot normally legislate on any matter included in the State List. Parliament can, however, do so if the Council of States recommends by at least two-thirds majority that such legislation is in national interest; if two or more States mutually agree that this should be done for such States, and to implement treaties or international agreements or conventions.

Expansion in State Intervention

The last four decades have witnessed an expansion in the scope for state intervention in the economy. The Constitution has been amended a number of times. The Constitution of India, which came into force in 1950, was first amended in the very next year. By the First Amendment of the Constitution, the State has been empowered to impose restrictions on the right of citizens to carry on any trade, business, industry or service with a view to enabling the state to undertake any scheme of nationalisation or prescribing the professional or technical qualifications necessary for practising any profession or carrying on any occupation, trade or business.

The State has, from time to time, acquired increasing powers to control private activity and enlarge its own ownership and management of the economy.

The brief account of the economic significance of the Indian Constitution given above makes it abundantly clear that the state has to shoulder a very heavy responsibility to attain the egalitarian goals set forth in the Constitution. Any responsibility should have commensurate authority also. Over the years, the Government has assumed enormous powers of control over the economy. How effectively and judiciously these powers have been exercised, and how satisfactorily the problems have been solved are different questions.

The Government has been very active in playing all the four important economic roles.

The last four decades have witnessed a clear trend towards an expanding control of the state over the various segments of the economy. With the increase in the problems, there has also been a tendency on the part of the Government to arm itself with more and more powers of control over the functioning of the economy.

The Industries Development and Regulation Act, the Company Law, the Capital Issues Control Act, the Securities Contracts Regulation Act, the Monopolies and Restrictive Trade Practices Act, the Essential Commodities Act, the Prevention of Blackmarketing and Maintenance of Supplies of Essential Commodities Act, the Conservation of Foreign Exchange and Prevention of Smuggling Activities Act, the Foreign Exchange Regulation Act, the Imports and Exports Control Act, etc., provide the Government with sweeping powers of control over industry, trade and commerce, so much so that Government cannot escape the responsibility for any shortfalls, drawbacks, or imperfections in these sectors of vital importance to the economy.

There are quite a good number of industrial and labour laws which regulate employer–employee relations, working conditions, wages, bonus, labour welfare and social security, etc.

The commercial banking sector has been brought under the effective control of the Reserve Bank of India by the Banking Companies Act of 1949 and the Amendment Acts of 1956 and 1962, the Banking Laws (Miscellaneous Provisions) Act, 1963, etc.

Indirect controls have also played their part in serving the national development goals. Various quantitative and qualitative monetary weapons have been deployed from time to time to regulate the economy, mainly to control prices. A number of fiscal and monetary incentives have been offered to encourage the growth of such priority sectors as the export industry, small industry and small business. Monetary, fiscal, financial and physical incentives have been provided for the accelerated development of the backward regions. Fiscal and monetary policies have also been employed as disincentives to discourage certain undesirable or inessential activities.

However, in recent years, the direct controls have considerably grown in importance.

No less important than the regulatory role is the promotional role of the Government in India. Being a mixed economy, the state has to provide the necessary facilities for the growth of the private sector. Our industrial policy has assigned an important role to the private sector in a number of industries. The Industrial Policy Resolution of 1956 has made it very clear that "it will be the policy of the state to facilitate and encourage the development of these industries in the private sector, in accordance with the programmes formulated in successive Five-Year Plans, by ensuring the development of transport, power and other services, and by appropriate fiscal and other measures. The state will continue to foster institutions to provide financial aid to these industries, and special assistance will be given to enterprises organised on co-operative lines for industrial and agricultural purposes." While shortcomings still exist, it should be said to the credit of the Government that a very remarkable progress has been achieved on these lines.

The expansion in the entrepreneurial/participative role of the state has been very spectacular. The public sector has grown substantially, both vertically and horizontally. In terms of contribution to net domestic product (NDP) at current prices, the share of the public sector as a whole has increased from about 10 per cent in 1960-61 to about 26 per cent today.

The total investment in the Central Government industrial enterprises has grown from Rs. 29 crores spread over 5 units on April 1, 1951, to Rs. 101,797 crores in over 236 units in 1991. In some industries, the public sector has absolute or near monopoly, and it has a commanding position in a number of basic and heavy industries.

Both fresh investments and nationalisation have contributed to the growth and expansion of the public sector.

More than 90 per cent of the commercial banking sector is in the hands of the state. Successive nationalisations — the nationalisation of the Imperial Bank and the establishment of the State Bank of India in 1955, the nationalisation of 14 major private banks in 1969 and another six in 1980 —have been mainly responsible for it. The insurance business in the country, too, has been nationalised.

Apart from monopoly in the field of railway transport, communications and air transport, the public sector accounts for a considerable share in shipping and road passenger transport. In the energy sector, the public sector has virtual monopoly in coal mining, exploration and refining of petroleum and in the generation and supply of electricity.

The public sector corporations today account for about one-tenth of the country's total foreign trade. Imports and exports of certain important items are *canalised* through public sector agencies.

The public distribution system has been expanded to remove the imperfections in the distribution of essential goods and to protect the interests of the vulnerable sections.

The Government has been playing a major role as a planner. The Planning Commission was set up in 1950 and the First Five Year Plan was launched in 1951 with the objective of achieving a rapid rise in the standard of living of the people by an efficient exploitation of the resources of the country, increasing production and offering opportunities to all for employment in the service of the community. Our Five-Year Plans place special emphasis on improvements in the living conditions of the poor. The objective of distributive justice has been given added emphasis in the later Plans.

A significant aspect of Indian planning is the respect for democratic and property rights, unlike in the centrally planned economies. In Indian planning, there has been the balancing of the various economic elements and a sort of a fusion of the public, private and joint sectors, heavy and light industries, and big, medium, small and cottage industries.

In short, as Rosan observed, unquestionably, the Indian government held the levers that determine the levels of output of all large and medium-sized firms by: (1) its own direct production of a wide variety of inputs and final products; (2) its grant, or refusal, of permission to private firms to produce new items or to expand production; (3) its provision of capital funds to, and control of security issues by, private firms; (4) its control of access to foreign exchange; and, (5) its control of imports.[9] There has, however, been a general relaxation is these controls.

---

[9] George Rosan, *Industrial Change in India: 1970-2000* (Ahmedabad: Allied Publishers Pvt. Ltd.) 1988, p.15.

8

Monetary and Fiscal Policies

The Monetary and Fiscal Policies have important influence on the Gross National Product (GNP)

GNP=C+I+G+X

Where :

C = Private consumption expenditure

I = Private investment expenditure

G = Government expenditure

X = Net exports

Three of the components of the GNP, namely C, I and X can be influenced by the monetary policy. The other component, G, is influenced by the fiscal policy which can also influence the private consumption and investment spendings and exports and imports.

The Government and the Central Bank* make use of various fiscal and monetary weapons respectively to achieve stability and growth by influencing and regulating the behavour of the various classes of spenders as savers, consumers and investors. In other words, the fiscal and monetary policies are also important determinants of business prospects and investment decisions. They can help make the overall economic situation and business prospects bright or check an unwarranted boom or unhealthy demand explosion. They can encourage investment and production in certain priority sectors and discourage them in the non-priority sectors. They are also capable of influencing technological choice and investment and production patterns. In short, the fiscal and monetary policies can influence the aggreagte supply and demand and the associated levels of employment, wages, interest, rent, prices and profit. Hence the importance of monetary and fiscal policies.

---

* **In India, the Central Bank is called the Reserve Bank of India.**

MONETARY POLICY

Monetary Policy refers to the use of instruments within the control of the Central Bank to influence the level of aggregate demand for goods and services or to influence the trends in certain sectors of the economy. Monetary policy operates through varying the cost and availability of credit, these producing desired changes in the assets pattern of credit institutions, principally commercial banks. These variations affect the demand for, and the supply of, credit in the economy, and the level and nature of economic activities.

The modern economy is regarded as a *credit economy* in the sense that credit forms the basis of most of the economic activities in such an economy. The level and nature of economic activities in such an economy, obviously, are influenced by the cost and availability of credit. The central bank's policies that affect the demand for, and the supply of money, therefore, are very important to the industrial and commercial sectors. In a developed economy, credit forms a very important component of money supply.

Measures of Money Stock

A knowledge of the measures of money stock in an economy would help us to understand monetary policy better.

The Reserve Bank of India employs four measures of money stock, nemely-M_1, M_2, M_3 and M_4.

M_1

The measure of money stock designated by M_1 is usually described as the *money supply.* The components of money supply are *currency with the public* (i.e., notes in circulation, circulation of rupee coins and circulation of small coins) and *deposits* (demand deposits with banks and other deposits with the RBI). As at the end of September 1995, M_1 was Rs. 192,699 crores.

Currency with the public forms less than half of the total money supply, whereas the demand deposits constitute more than 50 per cent of the money supply today.

In advanced countries, demand deposits form a major part of the money supply. In the USA, for instance, currency with the public forms less than one-fourth of the money supply. In India, the proportion of the currency in money supply has been declining. Two decades ago, it formed about three-fourths as against less than 50 per cent today.

M_2

M_2 is M_1+Post Office Savings Bank Deposits. As at the last Friday of September 1995, M_2 was Rs. 197,740 crores.

M_3

M_3 is M_1+Time Deposits with the banks. In other words, M_3 is money supply *plus* fixed deposits with the banks. M_3 is usually referred to as *aggregate monetary* resources. As on last Friday of September 1995, M_3 was Rs. 549,785 crores.

M4

M_4 is M_3 plus the total Post Office Deposits. As on the last Friday of September 1995, M_4 was Rs. 575,754 crores.

Monetary Policy and Money Supply

As has been mentioned earlier, money supply comprises currency with the public and demand deposits. Both the monetary and fiscal policies can affect money supply.

The budgetary operations of the Government considerably affect the money supply. If the Government meets its budgetary deficits by borrowing from the Reserve Bank, there will be an increase in money supply, both in currency and bank deposits. It may be mentioned here that there is no statutory limit on the extension of credit by the RBI to the Government. However, the RBI has no control over budgetary operations, though it has opportunities of tendering advice to Government on this matter.

Another source of variation in money supply, over which the RBI's influence is restricted, is the country's international payments position.

Demand deposits are a very important determinant of money supply. In advanced countries, demand deposits form a major part of money supply. For instance, in the USA, it forms over three-fourths of the money supply. In underdeveloped countries, the proportion of demand deposits in the money supply is comparatively smaller. In India, demand deposits constitute about 50 per cent of the money supply today; over three decades ago, they formed only about 25 per cent. In India, the proportion of demand deposits in money supply has been, thus, increasing. This is a trend associated with economic development and improvements in the *bankisation* and banking habits of the people.

Deposits with banks may originate in two ways—through *passive* creation or *active* creation. The former occurs when banks open deposit accounts for customers against the receipt of value either in cash or cheques drawn on other banks. The latter takes place when banks create deposits by extending credits. In the first case, the immediate effect is that there is no addition to the quantum of money, though its distribution may undergo a change; but ultimately it enables the banks to extend credit and thus results in an increase in money. In the second instance, the supply of money is augmented immediately. When a bank extends credit, it would result partly in a rise in deposits either with itself or with other banking institutions. Under the fractional reserve system, the banks can create deposits by a multiple of the reserves, since the payments made with the proceeds of bank loans are eventually redeposited with banks, leading to additional reserve funds.

Central banking instruments of control operate by varying the cost and availability of credit, and these produce desired changes in the assets pattern of credit institutions, principally commercial banks. The item among bank's assets having special significance in this connection is the credit extended by banks to their constituents, which is the sum of what are usually called *loans* and *discounts*. The capacity of banks to provide credit depends on their cash reserves (comprising cash in hand and balances with the Reserve Bank), a substantial portion of the reserves being generally held in the form of balances with the Reserve Bank. These increase through a rise in the deposit resources of banks, or by their borrowing from the Reserve Bank, or by sale of their investments. The regulation of credit by the Reserve Bank in essence means regulation of the quantum of the reserves of banks. If the Bank desires to bring about an expansion in credit, it adopts measures to augment the banks' reserves. If credit is to be restricted, it attempts to curtail the reserves.

Instruments of Monetary Policy

The instruments of monetary policy (methods of credit control) may be broadly divided into:

(i) General (Quantitative) methods; and

(ii) Selective (Qualitative) methods.

The general methods affect the total quantity of credit and affect the economy generally. The selective methods, on the other hand, affect certain select sectors. In other words, under the selective methods, certain qualitative distinctions are made between different sectors and segments of the economy, and selectivity is applied in regulating the flow of credit.

The statutory basis for the regulation of credit in India is embodied in the *Reserve Bank of India Act* and the *Banking Regulation Act*. The former Act confers on the Bank the usual powers available to central banks generally, while the latter provides special powers of direct regulation of the operations of commercial and co-operative banks.

General Credit Controls

There are three general or quantitative instruments of credit control, namely, the Bank Rate, Open Market Operations and Variable Reserve Requirements.

In considering the general methods of credit control, it is important to stress that these are closely inter-related and have to be operated in co-ordination. All the three instruments affect the level of bank reserves. Open Market Operations and the Reserve Requirements directly affect the reserve base, while the Bank Rate produces its impact indirectly by variations in the cost of acquiring the reserve.

The use of one instrument rather than another at any point of time is determined by the nature of the situation and the range of influence it is desired to wield as well as the rapidity with which the change is required to be brought about. Open Market Operations, for instance, are suited to carry out day-to-day adjustments on even the smallest scale. Changes in Reserve Requirements produce an impact at once and affect the banks generally. The effects of Bank Rate changes are not confined to the banking system and the short-term money market; they have wider repercussions on the economy as a whole.

Bank Rate: The Bank Rate, also known as the *Discount Rate*, is the oldest instrument of monetary policy. The traditional definition of Bank Rate is that it is the rate at which the central bank discounts — or, more accurately, rediscounts — eligible *bills*. However, today, the term Bank Rate is used in a broader sense and refers to *the minimum rate at which the central bank provides financial accommodation to commercial banks in the discharge of its function as the lender of the last resort.*

The Bank Rate policy seeks to affect both the cost and availability of credit. The availability depends largely on the statutory requirements regarding the eligibility of bills for rediscounting, and securities for collateral for advances, as also the maximum period for which the credit is available.

As the central bank is the *lender of the alst resort*, a commercial bank which is *loaned up* can obtain financial accommodation (i.e., loan) from the central bank and re-lend it to its own customers.

An increase in the Bank Rate means an increase in the rate of interest charged by the central bank on its advances to commercial banks. Hence, an increase in the Bank Rate compels commercial banks to raise the rate of interest they charge on their loans and advances to their customers and *vice-versa.*

The importance of the Bank Rate lies in the fact that it acts as a pace-setter to all the other rates of interest. In a well-developed money market, like the London Money Market, all the market rates quickly and effectively respond to a variation in the Discount Rate.

An increase in the Bank Rate implies an increase in the cost of credit and *vice-versa*. The demand for credit usually varies with the variation in the cost of credit. The central bank can, therefore, hope to bring about a contraction in the money supply by raising the Bank Rate and an expansion in the money supply by lowering it.

As per the theory of Bank Rate, an increase in the Bank Rate reduces the extent of borrowings from the money market, the level of inventory holding, investment, employment and prices. A reduction in the Discount Rate has the opposite effects. The central bank may, therefore, attempt to contain an inflationary situation by raising the Bank Rate and fight a depression or recession by lowering it.

Open Market Operations: Open Market Operations refer broadly to the purchase and sale by the central Bank of a variety of assets, such as foreign exchange, gold, Government securities and even company shares. In India, however, in practice, they are confined to the purchase and sale of Government securities.

Under the Open Market Operations, the central bank seeks to influence the economy either by increasing the money supply or by decreasing the money supply.

To increase the money supply, the central bank buys securities from commercial banks and public. For instance, if the Reserve Bank of India buys securities worth Rs.100 crores, in the first instance the reserves of the commercial banks and currency with the public will increase by Rs. 100 crores. However, the ultimate increase in money supply might be much more than this. When the central bank purchases securities from commercial banks the increase in their reserves might result in a *multiple credit creation*. Sometimes the purchase from the public may lead to an increase in the reserves of the banking system and credit expansion if the sellers of securities deposit the receipts with commercial banks. A sale of securities by the central bank has the opposite effects.

The capacity of a central bank to conduct Open Market Operations depends on the quantity and type of assets it can hold in its portfolio and the size and depth of the gilt-edged market. The Indian gilt-edged market is, however, narrow. A sizable proportion of the public debt is held by a few large institutions, and the volume of transactions in the securities market for the purpose of varying their portfolios is limited.

Unlike in the USA and the UK, where Open Market Operations are mainly in Treasury bills, in India the Open Market Operations are entirely in Government bonds in the absence of a Treasury bill market in India, and to that extent the potency of Open Market Operations is reduced. As in most other countries, in India also, Open Market Operations have not been used extensively to influence the cost and availability of credit through changes in the cash reserves of banks; assisting Government debt operations and providing seasonal finance to banks have been the main concern. Open Market Operations have nevertheless been generally in line with the Bank's monetary policy.

Open Market Operations have been employed by the Reserve Bank primarily to assist the Government in its borrowing operations and to maintain orderly conditions in the gilt-edged market. In this process, this instrument has been used to groom the market by purchasing securities nearing maturity to facilitate redemption and to make available *on tap* a variety of loans to broaden the gilt-edged market. As banker to the Government, it is the duty of the Reserve Bank to create in the gilt-edged market conditions that are favourable to the successful implementation of the

Government's borrowing and refunding operations. On the other hand, the Government's loan operations themselves are so arranged as to be in harmony, as far as possible, with the general stability of the money and capital markets. Open Market Operations have also been used to provide seasonal finance to banks. In the slack season, banks generally invest their surplus funds in Government securities, which they sell (or against which they borrow) during the busy season, in order to expand credit to industry and commerce, the Reserve Bank being generally ready to deal in these securities.

Variable Reserve Ratios

Commercial banks in every country maintain, either by the requirement of law or by custom, a certain percentage of their deposits in the form of balances with the central bank. The central bank has the power to vary this reserve requirement; and the variation in the reserve requirements affect the credit creating capacity of commercial bank. For instance, if the reserve requirement is 10 per cent, the maximum amount the bank can lend is equivalent to 90 per cent of the total reserves. If the reserve ratio is raised to 20 per cent, the bank cannot lend more than 80 per cent of the total reserves.

The Reserve Bank of India is empowered to vary the cash reserve ratio between 3 per cent and 15 per cent of the total demand and time liabilities. To facilitate the flexible operation of this system, the RBI has also been vested with the power to require the scheduled banks to maintain with it additional cash reserves, computed with reference to the excess of their total demand and time liabilities over the level of such liabilities on the base date to be notified by the Reserve Bank, subject to the proviso that the total reserves to be maintained with the Bank should not exceed 15 per cent of their demand and time liabilities.

SLR: Action has also been taken to prevent banks from offsetting the impact of variable reserve requirements by liquidating their Government security holdings. The Banking Regulation Act has been amended, requiring all banks to maintain a minimum amount of liquid assets which shall not be less than a certain specified percentage of their demand and time liabilities in India, *exclusive* of the cash balances maintained under Section 42 of the Reserve Bank of India Act in the case of scheduled banks, and *exclusive* of the cash balances maintained under Section 18 of the Banking Regulation Act in the case of non-scheduled banks. This ensures that with every increase in the cash reserve requirements, the overall liquidity obligations are also correspondingly raised.

Selective Credit Regulation

Slective or qualitative credit control refers to regulation of credit for specific purposes or branches of economic activity. While general credit controls operate on the cost and total volume of credit, selective controls relate to the distribution or direction of available credit supplies. It may be mentioned here that some element of selectivity can be imparted to general credit controls also by giving concessions to priority sectors or activities. This has often been done in India.

The aim of selective controls is to discourage such forms of activity as are considered to be relatively inessential or less desirable. Selective credit controls have been used in Western countries to prevent the demand for durable consumer goods outrunning the supply, and generating inflationary pressures. In the USA, they have been used to regulate stock market credit as well. In India, such controls have been used to prevent speculative hoarding of commodities like foodgrains and essential raw materials to check an undue rise in their prices. In addition to slective credit controls, many central banks have acquired powers of direct regulation of the total magnitude, as also the distribution of advances and investments of individual banks as well as of the entire banking system.

Selective credit controls are considered to be a useful supplement to general credit regulation. From available experience, it appears that their effectiveness is greatly enhanced when they are used together with general credit controls. They are designed specifically to curb excesses in selected areas without affecting other types of credit. They attempt to achieve a reasonable stabilisation of the prices of particular commodities on the demand side, by regulating the availability of bank credit for purchasing and holding them. It should, however, be noted that prices are determined by the inter-action of supply and demand, and that when supply is substantially short, what selective credit controls are likely to accomplish is to moderate the price rise rather than arrest the basic trend.

The Banking Regulation Act confers on the Reserve Bank the power to give directions to banking companies, either generally or to any banking company or group of banking companies in particular, as to —

(a) the purposes for which advances may or may not be made;

(b) the margin to be maintained in respect of secured advances;

(c) the maximum amount of advances or other financial accommodation which, having regard to the paid-up capital, reserves and deposits of a banking company and other relevant considerations, may be made by that banking company to any one company, firm, association of persons or individual;

(d) the maximum amount up to which, having regard to the considerations referred to in clause *(c)*, guarantees may be given by a banking company on behalf of any one company, firm, association of persons or individual; and

(e) the rate of interest and other terms and conditions on which advances or other financial accommodation may be made or guarantees may be given.

The Reserve Bank is also empowered to issue, from time to time, to banking companies generally or to any banking company in particular, such directions as it deems fit in the public interest; or in the interest of banking policy; or to prevent the affairs of any banking company from being conducted in a manner detrimental to the interests of the depositors; or in a manner prejudicial to the interests of the banking company; or to secure the proper management of any banking company generally. The banking companies or the banking company, as the case may be, shall be bound to comply with such directions.

Further, the Reserve Bank may caution or prohibit banking companies generally or any banking company in particular against entering into any particular transaction or class of transactions, and generally give advice to any banking company.

From time to time, the Reserve Bank has asked banks in its circular letters to exercise caution in their lending in general as well as lending against the security of specified commodities and shares.

The techniques of selective credit controls used generally are:

(a) Minimum margins for lending against specific securities;

(b) Ceilings on the amounts of credit for certain purposes; and

(c) Discriminatory rates of interest charged on certain types of advances.

In India, selective credit controls are operated under all the three techniques. While imposing selective controls, care is generally taken to ensure that credit for production, the movement of commodities and exports, is not affected. Selective controls are focussed mainly on credit to traders financing inventories.

Moral Suasion: In addition to the abovementioned methods of credit control, both quantitative and qualitative, it may be noted that the use has also been made in this country of moral suasion. Periodically, letters are issued to banks urging them to exercise control over credit in general or advances against particular commodities or unsecured advances. Discussions are also held with bankers for the same purpose. Such discussions between the bank and commercial banks have been frequent. The RBI has been able to build up over the years good informal relations with banks. Moral suasion, backed as it is by the Bank's vast powers of direct regulation, has proved quite useful. The use of this instrument is facilitated by the concentration of banking business in the hands of the Government.

FISCAL POLICY

Fiscal policy is that part of Government policy which is concerned with raising revenue through taxation and other means and deciding on the level and pattern of expenditure.

The fiscal policy operates through the *budget*. The Budget is an estimate of Government expenditure and revenue for the ensuing financial year, presented to Parliament (in case of *Union* Budget) usually by the Finance Minister. Occasionally, in times of financial crisis, *interim* Budgets may be introduced later in the year to increase taxation, expenditures, etc. Sometimes there may be slight modifications in taxation and expenditure without the formality of a revised budget.

THE UNION BUDGET

The Constitution of India provides that-

(i) No tax can be levied or collected except by authority of law;

(ii) No expenditure can be incurred from public funds except in the manner provided in the Constitution; and

(iii) The executive authorities must spend public money only in the manner sanctioned by Parliament in the case of the *Union* and by the State legislature in the case of a State.

An estimate of all anticipated revenue and expenditure of the Union Government for the ensuing financial year is laid before Parliament on the last working day of February every year. This is known as the *Annual Financial Statement* or the *Budget* and covers the Central Government's transactions of all kinds in and outside India during the year in which the statement is prepared as well as the ensuing year, or the Budget year, as it is known.

All receipts and disbursements of the Union Government are kept under two separate headings, namely, the *Consolidated Fund of India* and the *Public Account of India*. All revenues received, loans raised and money received in repayment of loans by the Union Government form the Consolidated Fund. No money can be withdrawn from this Fund except under the authority of an Act of Parliament. All other receipts and disbursements, such as deposits, service funds and remittances go into the Public Account, which is not subject to the vote of Parliament. To meet unforeseen needs not provided in the *Annual Appropriation Act*, a *Contingency Fund of India* has also been established under Article 267 *(i)* of the Constitution.

The presentation of the Annual Financial Statement is followed by a general discussion on the Budget in both the Houses of Parliament. The estimates of expenditure from the Consolidated Fund of India are then placed before the Lok Sabha in the form of *Demands for Grants*. Ordinarily, a separate *demand* is made for each Ministry. All withdrawals of money from the Consolidated Fund are thereafter authorised by an *Appropriation Act* passed by Parliament every year. The tax proposals of the Budget are embodied in another Bill, which is passed as the *Finance Act* of the year.

The receipts and expenditure of the Central and State Governments are audited by the Comptroller and Auditor-General who is independent of the executive, and his reports on the accounts are submitted to the President/Governor for having them laid before Parliament/State legislature.

The Structure of the Budget

The Budget is divided vartically into *revenue* (*receipts*) and *expenditure* (*disbursements*). Horizontally, it is divided into *revenue account* and *capital account*. The receipts are, thus, broken up into Revenue Receipts and Capital Receipts; and disbursements are broken up into Revenue Expenditure and Capital Expenditure.

The revenue expenditure includes all current expenditure of the Government on administration, and the capital expenditure includes all the capital transactions of the Government.

The revenue receipts include revenue from taxes, while capital receipts include market loans, external aid, income from repayments and other receipts, such as income from public undertakings.

STATE BUDGETS

Like the Union Government, State Governments, too, have their own budgets. Estimates of receipts and expenditure are presented by the State Governments to their legislatures before the beginning of the financial year and legislative sanction for expenditure is secured through similar procedure.

As in the case of the Union Government, the Consutution has provided for the establishment of a *Consolidated Fund*, a *Public Account* and a *Contingency Fund* for each State.

FINANCES OF THE UNION AND STATES

The Constitution of India has earmarked separate sources of revenue for the Union and the States.

Sources of Revenue for the Union

The Union List in the Constitution includes the following revenue subjects:

(i) Taxes on income other than agricultural income;

(ii) Duties and customs, including export duties;

(iii) Duties of excise on tobacco and other goods manufactured or produced in India, except alcoholic liquors for human consumption and opium, Indian hemp and other narcotic drugs and narcotics;

(iv) Corporation tax;

(v) Taxes on the capital value of assets, exclusive of agricultural land, of individual companies; taxes on the capital of companies;

(vi) Estate duty in respect of property other than agricultural land;

(vii) Duties in respect of succession to property other than agricultural land;

(viii) Terminal taxes on goods of passengers carried by the railways, by sea, or air; taxes on railway fares and freight;

(ix) Taxes other than stamp duties on transactions on stock exchanges;

(x) Rate of stamp duty on bills of exchange;

(xi) Taxes on sale or purchase of newspapers and on advertisements published therein;

(xii) Fees in respect of any of the matters in the Union List, but not including fees taken in any court;

(xiii) Any tax not mentioned in the State List or Concurrent List.

Sources of Revenue for the State

The State List in the Constitution includes the following revenue subjects :

(i) Land revenue, including the assessment and collection of revenue, the maintenance of land records, survey for revenue purposes and records of rights and alienation of revenue.

(ii) Taxes on agricultural income.

(iii) Duties in respect of succession to agricultural lands.

(iv) Estate duty in respect of agricultural land.

(v) Taxes on lands and buildings.

(vi) Taxes on mineral rights, subject to any limitations imposed by Parliament by law relating to mineral development.

(vii) Duties of excise on the following goods manufactured or produced elsewhere in India : (a) alcoholic liquors for human consumption; (b) opium, Indian hemp and other narcotic drugs and narcotics.

(viii) Taxes on the entry of goods into a local area for consumption, use or sale therein.

(ix) Taxes on the consumption or sale of electricity.

(x) Taxes on the sale or purchase of goods (other than newspapers).

(xi) Taxes on advertisements (other than those on newspapers).

(xii) Taxes on goods and passengers carried by road or inland waterways.

(xiii) Taxes on vehicles, whether mechanically propelled or not, used on roads.

(xiv) Taxes on animals and boats.

(xv) Tolls.

(xvi) Taxes on profession, trades, callings and employment.

(xvii) Capitation taxes.

(xviii) Taxes on luxuries, including taxes on entertainment, amusements, betting and gambling.

(xix) Rates of stamp duty in respect of documents other than those specified.

(xx) Fees in respect of any of the matters in this list but not including fees taken in any court.

(xxi) Fisheries.

(xxii) Forests.

(xxiii) Irrigation, water-storage and water power.

Concurrent List

The main revenue items in the Concurrent List under the Constitution are:

(i) Stam duties other than duties or fees collected by means of judicial stamps but including rates of stamp duty.

(ii) Fees in respect of any of the matters in this list but not including fees taken in any court.

The Finance Commission

Under the Constitution of India, a Finance Commission is to be constituted every fifth year or at such earlier time as the President considers necessary to make recommendations to the President as to:

(i) The distribution between the Union and States of the net proceeds of taxes which are to be or may be divided between them under the Constitution and the allocation between the States of the respective shares of such proceeds;

(ii) The principles which should govern the grants-in-aid of the revenues of the State in need of such assistance out of the Consolidated Fund of India; and

(iii) Any other matters referred to the Commission by the President in the interest of sound finance.

The recommedations of the Commission, together with an explanatory memorandum as to the action taken thereon, are laid before each House of Parliament. Ten Finance Commissions were constituted since the commencement of the Constitution.

IMPORTANCE OF THE BUDGET

There is no other Government measure that affects the whole economy as the Budget. No wonder all sections of the people await the annual Budget with mixed feelings— anxiety, fear and hope. The endeavour of the Finance Minister is to present a Budget which gives maximum support to forces that can move the country forward on the path of growth with stability and social justice. The Budget should set the stage for the achievement of economic and social goals.

The importance of *functional finance* and *pump priming* are recognised all over the world.

In India, today, over one-third of the GNP is channelled into the Government sector by the Union and State Budgets and disbursed by the Union and State Governments under various development and non-development heads. These indicate the development and distributive importance and implications of the Budgetary operations.

There has been a steep increase in the Government expenditures, both in absolute and relative terms. Total Government expenditures increased from about one-fifth of the GDP at market prices in 1970-71 to over one-third today. The Central Government expenditures alone account for about one-fourth of the GNP today.

Gross capital formation out of the Budgetary operations of the Central Government increased from Rs. 129 crores in 1950-51 to Rs.37,414 crores in 1991-92. By the Fourth Plan, Gross Capital formation out of the Central Government Budgetary resources increased to over 10 times the figure for the First Plan.

In a developing economy like India, the Budget policy has to serve the following purposes :

(i) Accelerate the pace of economic development by mobilising resources for the public sector and their optimal allocation;

(ii) Effect improvement in production in the private sector in accordance with the national priorities;

(iii) Effect improvements in income distribution;

(iv) Promote exports and encourage import substitution; and

(v) Achieve economic stabilisation.

To serve these purposes, apart from the judicious allocation of the Budgetary resources, various fiscal incentives and disincentives are also employed by the Budget. An examination of the *Budget Proposals* will make these very clear.

In short, both monetary and fiscal operations have repercussions on the whole economy, affecting the price level, the balance of payments, the levels of industrial activity and employment. While the monetary policy influences economic trends, especially inventory investment, through the cost and availability of credit, fiscal policy directly affects the financial resources and purchasing power in the hands of the public. In a country which has adopted a programme of planned economic development, in which the public sector has an important part to play, fiscal policy is concerned largely with effecting structural changes in the economy, while monetary policy aims at regulating investment in the private sector and short-run management of the economy. When economic objectives are set, both monetary and fiscal policies should aim at achieving these objectives. If they are to be successful, a close co-ordination of monetary and fiscal policies is necessary, for they are complementary and not competitive.

9

Industrial Policy

The Industrial Policy of the Government of India and the regulatory measures introduced to achieve the policy objectives have always been matters of severe controversy. While the industrialists and many others in India and abroad and many foreign governments and international development organisations regarded the policy as too restrictive and the regulations and procedures too cumbersome and perplexing, the leftists in India were demanding a more restrictive regime and are now opposing the liberalisations.

The era of deregulation ushered in by the Narasimha Rao government is an open acknowledgement of the failure of the control regime to deliver the goods. The Indian planners were fascinated and influenced by the Russian model so that the development strategy in India was directed towards creating a *socialist pattern* of society. It is interesting to note that recently the Soviet newspaper *Izvestia*, which observed that many elements of the Indian economic system were borrowed from the Soviet model, stated that the main culprit for the present economic crisis in India was the obsolete economic system based on socialism.

The industrial policy and regulation had grown more and more restrictive until about the mid Seventies. Having realised the deleterious effects of the restrictive regime, the 1980s saw a very slow process of liberalisation.

The following page give a brief review of the industrial policy since Independence.

INDUSTRIAL POLICY RESOLUTION, 1948

The Industrial policy Resolution of 1948 which envisaged that the "State must play a progressively active role in the development of industries" established exclusive monopoly of the Central Government in the case of (i) manufacture of arms and ammunitions (ii) production and control of atomic energy and (iii) ownership and control of railway transport. Further, establishment of new undertakings in six other major industries (coal; iron and steel; aircraft manufacture; ship building; manufacture of telephone, telegraph and wireless apparatus, excluding radio receiving sets; and mineral oils) was made the exclusive responsibility of the State, except where, in the national interest, the State itself found it necessary to secure the cooperation of private enterprise subject to such regulations and controls as the Central Government prescribed. The rest of the industrial field was normally left open to the private enterprise, individuals as well as cooperative. However, the right of the State to participate in any of these industries and to take over any industry in appropriate cases was expressed in the Resolution.

The Industrial Policy Resolution of 1948, thus, envisaged a *mixed economy* and emphasised the entrepreneurial, promotional, regulatory and planning roles of the State in the industrialisation of the country.

INDUSTRIAL POLICY RESOLUTION, 1956

In the light of certain important developments—the enactment of the Constitution of India which guarantees certain Fundamental Rights and enunciates the Directive Principles of State Policy, the constitution of the Planning Commission and the inauguration of development planning, and the adoption by Parliament of the *socialist pattern of society* as the objective of social and economic policy—the Government felt it necessary to bring forth a fresh statement on industrial policy that must be governed by the principles laid down in the Constitution, the objective of socialism and the experience gained till then. A new Industrial Policy Resolution was, therefore, announced on 30th April 1956 and this remained the basic plank of the industrial policy until 1991.

The Resolution of 1956 made the industrial policy more socialist-oriented, and widened the scope of the public sector. In order to realise the aims specified in the preamble to the Constitution and to give effect to the Directive Principles of State Policy as well as to achieve the object of socialist pattern of society, it was decided that "the state will progressively assume a predominant and direct responsibility for setting up new industrial undertakings and for developing transport facilities. It will also undertake state trading on an increasing scale. At the same time, as an agency for planned national development, in the context of the country's expanding economy, the private sector will have the opportunity to develop and expand. The principle of co-operation should be applied wherever possible, and a steadily increasing proportion of the activities of the private sector be developed along co-operative lines." It was, thus, clear that the adoption of the principle of socialist pattern of society did not mean the end of the private sector. Instead, the private sector was assigned and expected to play an important role in the nation's economy. The Industrial Policy Resolution of 1956, thus, reiterated the resolve to foster national development through a system of mixed economy.

The role of the public sector was elucidated as follows : "The adoption of the socialist pattern of society as the national objective, as well as the need for planned and rapid development, require that all industries of basic and strategic importance, or in the nature of public utility services, should be in the public sector. Other industries which are essential and require investment on a scale which only the state, in present circumstances, could provide, have also to be in the public sector. The State has, therefore, to assume direct responsibility for the future development of industries over a wide area. Nevertheless, there are limiting factors which make it necessary at this stage for the state to define the field in which it will undertake sole responsibility for further development and to make a selection of industries in the development of which it will play a dominant role."

The Resolution classified industries into three categories, having regard to the role which the state would play in each of them.

(i) The first category contained industries "the future development of which will be the exclusive responsibility of the state." Industries in this category were listed in Schedule A of the Resolution. Schedule A contained 17 industries. These 17 industries also included railways and air transport, arms and ammunition, and atomic energy, which were to be developed as Central Government monopolies.

In the remaining industries in Schedule A, the expansion of the existing privately-owned units, or the possibility of the state securing the co-operation of private enterprise in the establishment of new units when the national interest so required, was not precluded. However, it was made clear that "whenever co-operation with private enterprise is necessary, the state will ensure, either through majority participation in the capital or otherwise, that it has the requisite powers to guide the policy and control the operations of the undertaking."

(ii) In the second category were included industries "which will be progressively state-owned and in which the state will, therefore, generally take the initiative in establishing new undertakings, but in which private enterprise will also be expected to supplement the efforts of the state." "With a view to accelerating their future development, the state will increasingly establish new undertakings in these industries. At the same time, private enterprise will have the opportunity to develop in this field, either on its own or with state participation."

The industries included in the second category were listed in Schedule B of the Resolution. Schedule B contained 12 industries.

(iii) The third category contained all the remaining industries and it was expected that "their development will be undertaken ordinarily through the initiative and enterprise of the private sector, though it will be open to the state to start any industry even in this category. It will be the policy of the state to facilitate and encourage and the development of these industries in the private sector, in accordance with the programmes formulated in successive five year plans, by ensuring the development of transport, power and other services, and by appropriate fiscal and other measures."

It was also made very clear that "the division of industries into separate categories does not imply that they are being placed in watertight compartments. Inevitably, there will not only be an area of overlapping but also a great deal of dovetailing between industries in the private and public sectors. It will be open to the state to start any industry not included in Schedule A and Schedule B when the needs of planning so require or there are other important reasons for it. In appropriate cases, privately owned units may be permitted to produce an item falling within Schedule A for meeting their own requirements or as by-products. There will ordinarily be no bar on small privately-owned units undertaking production, such as the making of launches and other light craft, generation of power for local needs and small scale mining. Further, heavy industries in the public sector may obtain some of their requirements of higher components from the private sector, while the private sector in turn would rely for many of its needs on the public sector. The same principle would apply with even greater force to the relationship between large-scale and small-scale industries."

The Industrial Policy Resolution of 1956 reiterated Government's determination to provide all sorts of possible assistance for the accelerated development of small and cottage industries in view of the distinct advantages they possess in respect of generation of large-scale employment by utilising locally available resources, wider dispersal of industrial activities and a more equitable distribution of income and wealth through diffusion of ownership.

Another important objective spelt out by the Resolution was the removal of regional disparities in development through the accelerated development of the regions lagging behind industrially. The need for proper infrastructural facilities for industrial development in the backward regions was emphasised by the Policy Resolution.

The Industrial Policy Resolution of 1956 has, thus, reiterated the faith in the virtues of a "mixed economy." While it clearly demarcated the areas of public and private sectors, it was at the same time sufficiently flexible to make the required adjustment and modifications in the national interest.

The policy was designed to enable the Government in due course to gain a dominant position in the industrial sector of the country. Hence, even a staunch socialist with pragmatic views could not find much fault with the Policy Resolution.

In view of the inadequacy of private entrepreneurship and related factors, it was indeed necessary that the State played a major role in the industrialisation of the country by its entrepreneurial role, regardless of the political philosophy. There were also areas which demanded government investment where private capital fought shy due to high risk and poor or no profit prospects, besides industries of strategic importance.

However, as it is clear from the Resolution, it was the combination of the above factors and the socialist orientation of the economic policy which gave the public sector such a predominant position. Even many who strongly support the present policy trends and the privatisation proposal feel that assigning a major role for the public sector in the early stages of development was a very appropriate policy although the State monopolisation of industries could not be justified, except in certain cases. Indeed, the industrial sector would have performed much better had the varied resources of the private sector were allowed to be utilised in many of the industries exclusively reserved for the State by the Policy Resolution.

REVIEW OF THE INDUSTRIAL LICENSING SYSTEM

Prevention of concentration of economic power and reduction of disparties in income and wealth were among the major objectives of economic policy in India. Quite naturally, these aspects were emphasised also by the industrial policy. In fact, the Constitution of India specifically directs the State to achieve these objects.

The Industrial Policy Resolution of 1956 had at the very outset quoted the relevant parts from the preamble and Directive Principles and emphasised the urgency "to reduce the disparities in income and wealth which exist today and to prevent private monopolies and the concentration of economic power in different fields in the hands of small number of individuals." The Industries (Development and Regulation) Act, enacted in 1951 with the main objective of giving practical effect to the Industrial Policy, gave the Government sweeping powers of control over the industrial sector.

There was, however, a growing impression that the operation of the economic system had been resulting in the distribution of the benefits of development more in favour of the upper strata. In particular, it was felt that industrial licensing had failed to realise the objectives of the industrial policy. The Government of India had, therefore, made some inquiries into these aspects.

The Planning Commission in 1960 appointed the "Distribution of Income and Levels of Living Committee (Mahalanobis Committee) to inquire how the additional income generated in the First and Second Plans had been spread in the country. In view of the suggestion made by the Mahalanobis Committee that more comprehensive and detailed information regarding the many aspects and ramifications of economic power and controls in the private sector be obtained, a five member Monopolies Inquiry Commission under the Chairmanship of Mr. Das Gupta was appointed by the

Central Government in April 1964 to inquire into various aspects of concentration of economic power and monopolistic and restrictive trade practices and to suggest corrective legislative measures. In 1966, Professor Hazari was appointed Honorary Consultant by the Planning Commission to review the operation of licensing under the IDR Act, and to consider and suggest modifications in licensing accordingly.

Some of the important disclosures made by the reports of the above inquiries are given below :

(i) the working of the planned economy had contributed to the growth of big companies;

(ii) the working of the industrial licensing system enabled the large industrial houses to obtain a disproportionately large share of the licences issued;

(iii) some of the large industrial houses were guilty of non-implementation of licences and preemption or foreclosure of capacity;

(iv) the operation of the industrial licensing system was not successful in achieving the objective of regional dispersal of industries;

(v) the large industrial houses were the major beneficiaries of the public financial institutions.

The Industrial Licensing Policy Inquiry Committee (ILPIC), popularly known as the Dutt Committee, was appointed in July 1967 to inquire into the above observations. The Report of the Dutt Committee, submitted in July 1969, more or less confirmed most of the above conclusions.

The Dutt Committee suggested that the large industrial houses should be given licences only for projects involved in 'core' and 'heavy' investment sectors. It also identified industries falling in these sectors as being those having to do with basic metals, heavy machine building and heavy chemicals. It also observed that licences for non-priority industries should not, as a rule, be granted to concerns belonging to these houses.

The reports of the Monopolies Inquiry Commission, Professor Hazari and the Industrial Licensing Policy Inquiry Committee, thus, revealed that the operation of the licensing system failed to realise the objectives of the industrial policy. And this called for a re-orientation of the industrial licensing policy.

POLICY DEVELOPMENTS IN 1970s

The recommendations of the Planning Commission, the Administrative Reforms Commission and the Industrial Licensing Policy Inquiry Committee and a number of considerations prompted the Government to make certain changes in the licensing policy. Accordingly, an Industrial Licensing Policy was announced on 18th February 1970.

This policy classified industries into: (1) the Core Sector consisting of the basic, critical and strategic industries, (ii) the Heavy Investment Sector consisting of projects with investment of over Rs. 5 crores, (iii) the Middle

Sector consisting of projects involving investment of Rs. 1 crore to Rs. 5 crores, and (iv) the De-licensed sector where investment was less than Rs. 1 crore and was exempted from licensing.

Except for industries included in Schedule A of the Industrial Policy Resolution, 1956 (i.e., industries which were reserved for the public sector) undertakings belonging to the large industrial houses along with foreign concerns and subsidiaries or branches of foreign companies were expected, along with other applicants, to participate in and contribute to the establishment of industries in the core and heavy investment and export-oriented sectors.

In the middle sector, licence application of parties other than undertakings belonging to the large industrial house along with foreign concerns and subsidiaries or branches of foreign companies were expected, along with other applicants, to participate in and contribute to the establishment of industries in the core and heavy investment and export-oriented sectors.

In the middle sector, licence application of parties other than undertakings belonging to large industrial houses and foreign concerns were to be given special consideration. In this sector licences were to be issued more liberally except where foreign exchange implications necessitated careful scrutiny. Applications from undertakings belonging to large industrial houses and foreign concerns were to be considered for normal expansion where such expansion was necessary to develop to a minimum economic level which would ensure greater cost efficiency.

For the core sector and heavy investment sector, Government accepted the concept of the joint sector suggested by the Dutt Committee and proposed to apply this concept to the major projects to be taken up by the large industrial houses.

The Industrial Licensing Policy of 1970, thus, restricted the role of large industrial houses and foreign concerns to the core, heavy and export-oriented sectors. The main purpose was the promotion of new and small and medium entrepreneurs and the prevention of the concentration of economic power in a few hands.

In 1977, the newly formed *Janata Party* assumed power at the Centre and it made an industrial policy statement "directed towards removing the distortions of the past so that the genuine aspirations of the people can be met within a time-bound programme of economic development."

The main thrust of the new policy was on effective promotion of cottage and small industries widely dispersed in rural areas and small towns. It was decided that "whatever can be produced by small and cottage industries must only be so produced", and the list of industries which were excessively reserved for the small-scale sector was significantly expanded.

Within the small-sector, it was proposed to give special attention to units in the tiny sector, namely, those with investment in machinery and equipment upto Rs. 1 lakh and situated in towns with a population of less than 50,000 according to the 1971 census figures, and in villages. Further, special emphasis was given to the protection and promotion of khadi and village industries.

With a view to taking away the focal point of development for small-scale industries from the big cities and State capitals to district from the big cities and State capitals to district headquarters, District Industries Centres (DICs) were proposed to be set up to provide under a single roof all the services and support required by small and village entrepreneurs.

However, the new policy was not in any way significantly different from the previous policy.

INDUSTRIAL POLICY STATEMENT, 1980

The by-election of 1980 brought the Congress party, led by Mrs. Indira Gandhi, back to power with a thumping majority. The new Government announced its Industrial Policy on 23rd July, 1980.

The socio-economic objectives of the Industrial Policy Statement of 1980 were optimum utilisation of the installed capacity; maximising production and achieving higher productivity; higher employment generation; correction of regional imbalance through a preferential development of industrially backward areas; strengthening of the agricultural base by according a preferential treatment to agro-based industries, and promoting optimum inter-sectoral relationships; faster promotion of export oriented and import substituting industries; promotion of economic federalism with an equitable spread of investment and dispersal of returns amongst widely spread small but growing units in rural as well as urban areas; and consumer protection against high prices and bad quality.

Small doses of liberalisations with a view to accelerating domestic economic development and export growth were introduced following the Industrial Policy Statement of 1980.

POLICY LIBERALISATIONS IN THE EIGHTIES

Having realised the deleterious effects of the unpragmatic regulations, piecemeal measures of policy liberalisations began to be introduced by around the beginning of the nineteen eighties and this trend towards liberalisation gathered a little more momentum under the Rajiv regime. These liberalisation measures were introduced with the following objectives:

(i) acceleration of industrial development;
(ii) better capacity utilisation;
(iii) achieving economies of scale;
(iv) removing / reducing procedural impediments;
(v) development of backward areas;
(vi) export promotion and import substitution; and
(vii) increasing competitiveness and competition.

Important measures taken during the eighties to rejuvenate the industrial sector included :

(i) delicensing of a number of industries;
(ii) broad banding;*
(iii) facility for re-endorsement of higher capacity for production;
(iv) enlargement of list of industries open to large houses and foreign concerns and other policy relaxations in respect of MRTP and FERA companies;
(v) enhancement of investment limit for exemption from licensing;
(vi) enhancement of investment limit of small scale and ancillary units;
(vii) greater thrust to the industrialisation of backward areas;
(viii) greater thrust to industries with export potential;
(ix) liberalisation of import policy; and
(x) liberlisation of foreign collaborations.

These measures, although piecemeal in nature, have produced very favourable effects. They have imparted some amount of dynamism to the Indian economy, particularly to the industrial sector. Growth rates of industrial production and exports accelerated. The increase in competition and the gradual emergence of a buyer's market in several industries where a seller's market prevailed in the past has been encouraging technological upgradation, improvement in efficiency, more attention to quality, competitive pricing, more attention to after-sales service and customer satisfaction etc.

THE NEW INDUSTRIAL POLICY

The encouraging results of the liberalisations of the 1980s, drastic economic changes in many countries and the economic crisis that shadowed over the nation set the stage for a bold set of measures for an economic rejuvenation and accelerated pace of development.

On July 24, 1991, Government of India announced major changes in the industrial policy. The salient features of the new policy are:

(i) delicensing with certain exceptions;
(ii) liberalisation of foreign investment and technological participation;
(iii) scrapping of the MRTP regulations pertaining to concentration of economic power; and

---

* Broad banding means that the description of items of manufacture in the industrial licence would be in terms of broad generic category instead of rigidly defined specific products. For example, as a result of the broad banding, motorised two-wheelers came under a single category for licensing covering all types of two-wheelers — scooter, motorcyle or moped of any engine capacity not exceeding 350 --cc as against the previous situation under which a specific licence had been required for each product.

(iv) redefining of the role of the public sector.

The major objectives of the new industrial policy package are :

(i) to build on the gains already made;
(ii) to correct the distortions or weaknesses that may have crept in;
(iii) to maintain a sustained growth in productivity and gainful employment; and
(iv) to attain international competitiveness.

It has been stated that the pursuit of these objectives will be tempered by the need to preserve the environment and ensure the efficient use of available resources. All sectors of industry, whether small, medium or large, belonging to the public, private or co-operative sectors will be encouraged to grow and improve on their past performance.

In pursuit of the above objectives, significant changes have been introduced in the following areas, namely, (i) industrial licensing; (ii) foreign investment; (iii) foreign technology agreements; (iv) public sector policy and M.R.T.P. Act.

Industrial Licensing

An industrial licence was mandatory for investments above certain specified limit. This limit which was Rs. 5 crores was raised for non-MRTP / non-FERA companies to Rs. 15 crores in case of projects in non-backward areas and to Rs. 50 crores in backward areas, subject to certain conditions, in June 1988.

A licence was required not only for establishment of a new undertaking but also for substantial expansion of capacity of existing undertakings, manufacture of new items, continuation of business in certain cases and change of location of an industrial undertaking. As pointed out in chapter 1, it was widely acknowledged that the licensing system had a very deleterious effect on the industrial development.

The new policy has gone a long way in freeing the Indian industry from the shackles of control. Industrial licensing has been abolished, irrespective of levels of investment, for all industries except 18 specified industries which will continue to be subject to compulsory licensing for reasons related to security and strategic concerns, social reasons, problems related to safety and overriding environmental issues, manufacture of products of hazardous nature and articles of elitist consumption. This list was further pruned to 15 industries. See *Appendix* 10.1.

The exemption from licensing will apply to all substantial expansions of existing units. The existing and new industrial units will be provided with a broad banding facility to enable them to produce any article so long as no additional investment in plant and machinery is involved.

Changes have been affected in the MRTP Act and policy towards foreign investment and technology to extend the benefits of the delicensing to the large companies and foreign companies.

Further, all registration schemes, viz., delicensed registration, exempted industries registration and DGTD registration, have been abolished. Entrepreneurs now have only to file an information memorandum on new projects and substantial expansion.

The compulsory licensing provisions would not apply in respect of small-scale units taking up the manufacture of any of the items coming under the list of industries subject to licensing if they are reserved for exclusive manufacture in the small scale sector.

In a departure from the locational policy for industries, the new policy provides that in locations other than cities of more than one million population, there will be no requirement of obtaining industrial approvals from the centre except for industries subject to compulsory licensing. In respect of cities with a population of more than one million, industries other than those of non-polluting nature, will be located outside 25 kms. of periphery.

Public Sector Policy

As pointed out earlier, development of 17 industries were exclusively reserved for the public sector and in another 12 important industries the public sector was to play a dominant role. Further, the public sector could enter any other industry as and when the government so desired. As a result, there was a large expansion of the public sector, establishing monopoly or near monopoly or a dominant position in many industries, controlling the commanding heights of the economy.

In view of the development the nation has achieved by now and the unsatisfactory performance of the public sector, the new policy has redefined the role of the public sector. Accordingly, the number industries reserved for the public sector was pruned down to eight. This was further pruned to six. These six industries are defence products, atomic energy, coal and lignite, mineral oils, railway transport, and minerals specified in the schedule to the Atomic Energy Order, 1953.

The new policy also proposes selective privatisation of enterprises. Further, it is also proposed to close down unviable public enterprises and to bring the viable sick public sector units under the Board for Industrial and Financial Reconstruction (BIFR) or a separate body that may be created on the lines of the BIFR to deal exclusively with sick public sector units.

(For more details of the public sector policy, see the chapter on Public, Private, Joint and Cooperative Sectors.)

MRTP Act

The Monopolies and Restrictive Trade Practices Act, 1969, has had a very adverse effect on competition and industrial growth. The two principal objectives of the MRTP Act, 1969 were :

(i) prevention of concentration of economic power to the common detriment, and

(ii) prohibition of monopolistic, restrictive and other unfair trade practices which are prejudicial to the public interest.

The new policy acknowledges that with the growth and complexity of industrial structure and the need for achieving economies of scale for higher productivity and competitive advantage in the international market, the interference of government through the MRTP Act on the investment decisions of large companies has become deleterious in its effects on Indian industrial growth.

With a view to preventing concentration of economic power, the MRTP Act had laid down that dominant undertakings with assets of one crore or more and other undertakings which either by itself or together with interconnected undertakings had assets of Rs. 100 crore or more should obtain the prior permission of the central government for establishment of new undertakings, expansion of existing undertakings, merger, amalgamation or take over. The new policy has repealed these provisions. In other words, henceforth the MRTP Act will be confined mostly to the achievement of the second objective mentioned above, viz., prohibition of monopolistic restrictive and unfair trade practices.

It has been proposed that provisions of the MRTP Act will be strengthened in order to enable the MRTP Commission to take appropriate action in respect of the monopolistic, restrictive and unfair trade practices. The newly empowered MRTP Commission will be encouraged to require investigation *suo moto* or on complaints received from individual consumers or classes of consumers. Amendments will be made in the MRTP Act for enabling the MRTP Commission to exercise punitive and compensatory powers.

Foreign Capital and Technology

With a view to injecting the disired level of technological dynamism in Indian industry, the new policy provides for automatic approval for technology agreements related to high priority industries within specified parameters. 51 per cent foreign equity is also allowed in these industries. 35 industries have been specified in this category. These industries account for about 50 per cent value added in the manufacturing sector.

It may be noted that earlier foreign equity participation was restricted normally to 40 per cent and foreign investment and technology agreements needed prior approval.

The new policy has also made the import of capital goods automatic provided the foreign exchange requirement of such import is ensured through foreign equity.

Dividends to be expatriated by companies with foreign equity should be met through export earnings over a period of time. The policy towards NRI investments has also been liberalised.

(For more details, see the chapter on Foreign Capital and Technology.)

Convertability Clause

Financila institutions in India had the option to convert 20 per cent of their loans in all cases where the aggregate financial assistnace from the all India financial institutions exceeded Rs. 5 crores. This gave the financial institutions scope for acquiring considerable equity holding in such units and this was a matter of serious apprehension for the industrialists.

The new policy has scrapped the convertibility clause.

Policy for Small Scale Sector

A new policy for the small and tiny enterprises was announced by the Government on 6th August 1991.

The main thrust of the new policy is impart more vitality and growth to employment and exports. The salient features of the new policy are:

(i) De-regulation, de-bureaucratisation and simplification of statutes, regulations and procedures;

(ii) Increase in the investment limit in plant and machinery of tiny enterprises from Rs. 2 lakh to Rs. 5 lakh, irrespective of the location of the unit;

(iii) Inclusion of industry-related services and business enterprises, irrespective of their location, as small-scale industries;

(iv) Ensuring both adequate flow of credit on a normative basis and quality of its delivery for viable operation of the SSI sector;

(v) Settiing up of a special monitoring agency to oversee the genuine credit needs of the small-scale sector;

(vi) Introduction of suitable legislation to ensure prompt payment of small industries bills;

(vii) Introduction of a scheme of Integrated Infrastructural Development (including technological back-up services) for small-scale industries;

(viii) Setting up of a Technology Development Cell in the Small Industries Development Organisation;

(ix) Market promotion of SSI products through co-operative/public sector institutions, other specialised professional/marketing agencies and the consortia approach;

(x) Setting up of Export Development Centre in the Small Industries Development Organisation;

(xi) Permission for equity participation in small-scale units by other industrial undertakings upto 24 per cent of thier shareholding.

For more details, see chapter 15.

An Evaluation of the Policy Changes

The measures announced recently are revolutionary indeed in comparison with the policy and procedural reforms hitherto attempted in India. It undoubtedly is a bold step in the direction of freeing the Indian industry from the shackles of abortive and crippling controls, albeit a much bolder step is the need of the hour.

Although further policy changes and reform are needed, changes already introduced, if implemented in real earnest, will certainly provide a considerable growth impetus. However, real debureaucratising will be a challenging task. The bureaucracy has a tendency to attempt to defeat the measures aimed at deregulation.

A strong mandate and political will and bold administrative measures are essential for implementing several of the proposals. The government, however, often shows signs of confusion and lack of boldness on the face of opposition from trade unions, politicians and bureaucrats. There will certainly be strong opposition from these groups to protect their vested interests. For example, in the face of the strong opposition from the trade unions, the government's stand on privatisation is not clear. In our country the might of the organised minority often gets prominence over the rights and welfare of the unorganised majority.

The proposal for privatisation itself appears to be half hearted. Transferring a part of the share-holding to the public sector financial institutions is not going to make any significant impact. Privatisation of an enterprise will not be meaningful unless it is real and substantial.

The proposal to close down sick public sector units has also naturally come in for strong opposition. One should of course have sympathy to the workers who lose their job. But should the society go on bearing the burden of the heavy losses to provide employment? To the extent possible the problem should be solved by retraining and redeployment of the workers. The workers with their experience should be encouraged to take up employment elsewhere. They could also be encouraged to start something of their own with the sum of money they get while they quit.

The policy environment now in India is much more conducive for both domestic and foreign investments than in the past. However, there are now a host of countries trying to woo foreign investment with much more conducive economic environment than in India. Further, cultural factors also tilt the balance in favour of other nations as far as foreign investment is concerned. Many multinationals are busy establishing footholds in the newly opened markets of the 'communist' world. Further, foreign business still regard the policy and procedural system in India perplexing. Because of these factors one should not expect wonders out of the belated measures.

However, for the first time the domestic industry has been given a considerable leeway to prove its mettle. This dynamism coupled with an enhanced external collaboration and competition should be expected to provide a considerable momentum for development. At the same time the government should strive to remove the remaining lacunae and to implement the proposed reforms in letter and spirit.

(Also see the last chapter)

10

IDRA and Industrial Licensing

INDUSTRIES (DEVELOPMENT AND REGULATION) ACT, 1951

The industrial policy resolution lays down the national objectives to be achieved by industrialisation. It indicates the priorities, patterns and directions of development. To achieve these objectives, the Government should inevitably have the power to direct, regulate and control factors like industrial investment, location, expansion and growth, management, etc. The Industries (Development and Regulation) Act, 1951, amended from time to time, is one of the most effective weapons the Government possesses in this respect. It arms the Government with sweeping powers to regulate the development and control the activities of the industrial sector.

The object of the Act is to provide the Central Government with the means of implementing its industrial policy. The Act brings under Central control the development and regulation of a number of important industries, the activities of which affect the country as a whole and the development of which must be governed by economic factors of all-India import. It confers on the Central Government power to make rules for the registration of existing undertakings. The planning of future development on sound and balanced lines is sought to be secured by the licensing of all new undertakings by the Central Government. The Act also confers on the Government the power to make rules for regulating the production and development of Industries in the "Schedule" and for consultation with provincial Government on these matters. Provision has also been made for the constitution of a Central Advisory Council, prior consultation with which will be obligatory before the Central Government takes certain measures, such as the revocation of a licence or taking over the control and management of any industrial concern.

Coverage of the Act

The Act extends to the whole of India. Its provisions apply to all "industrial undertakings" manufacturing any of the items included in the

"Scheduled Industries". The "scheduled industries" are those industries which are included in the First Schedule to the Act.

The Act applies only to those "industrial undertakings" which are defined as such under the Act. The Act defines an industrial undertaking as any undertaking pertaining to a scheduled industry carried on in one or more "factories" by any person or authority including the Government.

For the purpose of the Act, a "factory" means any premises including the precincts thereof, in any part of which a manufacturing process is being carried on or is ordinarily so carried on :

(i) With the aid of power, provided that fifty or more workers are working or were working thereon on any day of the preceding twelve months; or

(ii) Without the aid of power, provided that one hundred or more workers are working or were working thereon on any day of the preceding twelve months and provided further that in no part of such premises any manufactruing process is being carried on with the aid of power.

Exemptions from the Act

Section 29-B of the Act empowers the Central Government to grant exemptions to this Act in certain cases. If the Central Government is of the opinion, having regard to the number of workers employed or to the amount invested in any industrial undertaking or to the desirability of encouraging small undertakings generally or to the stage of development of any scheduled industry, that it would not be in public interest to apply all or any of the provisions of the Act, it may, by notification in the Official Gazette, exempt, subject to such conditions as it may think fit to impose, any industrial undertaking or class of industrial undertakings, any scheduled industry or class of scheduled industries, as it may specify in the notification, from the operation of all or any of the provisions of this Act or any rule or order made thereunder.

Central Advisory Council and Development Councils

Section 5 of the Act provides that the Central Government may establish a Central Advisory Council for the purpose of advising it on matters concerning the development and regulation of the scheduled industries. The Advisory Council shall consist of a Chairman and other members, not exceeding thirty in number, all of whom shall be appointed by the Central Government from among persons who are in its opinion capable of representing the interests of the owners, employees, consumers, primary suppliers, etc., of the industrial undertakings in the scheduled industries.

The Act provides that the Central Government may establish for any scheduled industry or group of scheduled industries a Development Council which shall consist of members who, in the opinion of the Central Government, are capable of representing the interests of owners, employees and consumers of the industrial undertakings in the scheduled industry or groups of scheduled industries and persons having special knowledge of matters relating to the technical or other aspects of the scheduled industry or group of scheduled industries.

A development council may perform any of the following functions which may be assigned to it by the Central Government :

- (i) Recommending targets for production, co-ordinating production programmes and reviewing progress from time to time;
- (ii) Suggesting norms of efficiency with a view to eliminating waste, obtaining maximum production, improving quantity and reducing costs;
- (iii) Recommending measures for securing the fullest utilisation of the installed capacity and for improving the working of the industry, particularly of the less efficient units;
- (iv) Promoting arrangements for better marketing and helping in the devising of a system of distribution and sale of the produce of the industry which would be satisfactory to the consumer;
- (v) Promoting standardisation of products;
- (vi) Assisting in the distribution of controlled materials and promoting arrangements for obtaining materials for the industry;
- (vii) Promoting or undertaking inquiry as to materials and equipment and as to methods of production, management and labour utilisation, including the discovery and development of new materials, equipment and methods of improvements in those already in use; the assessment of the advantages of different alternatives and the conduct of experimental establishments and of tests on a commercial scale;
- (viii) Promoting the training of persons engaged or proposing engagement in the industry and their education in technical or artistic subjects relevant thereto;
- (ix) Promoting the re-training in alternative occupations of personnel engaged in or retrenched from the industry;
- (x) Promoting or undertaking scientific and industrial research, research into matters affecting industrial psychology and research into matters relating to the production and the consumption or use of the goods and services supplied by the industry;
- (xi) Promoting improvements and standardisation of accounting and costing methods and practices;

(xii) Promoting or undertaking the collection and formulation of statistics;

(xiii) Investigating possibilities of decentralising stages and processes of production with a view to encouraging the growth of allied small-scale and cottage industries;

(xiv) Promoting the adoption of measures for increasing the productivity of labour, including measures for ensuring safer and better working conditions and the provision and improvement of amenities and incentives for workers.

(xv) Advising on any matters relating to the industry (other than remuneration and conditions of employment) on which the Central Government may request the Development Council to advise it and undertaking inquiries for the purpose of enabling the Development Council to advise; and

(xvi) Undertaking arrangements for making available to the industry information obtained and for advising on matters with which the Development Council is concerned in the exercise of any of their functions.

A development council shall also perform such other functions as it may be required to perform under any other provision of this Act.

Regulation of Scheduled Industries

(i) Registration of undertakings : The Act provided that all the industrial undertakings that existed, including the industrial undertakings of which the Government was the owner, in the scheduled industries which were listed in the First Schedule to the Act, should be registered with the Government within the prescribed period and issued with a certificate of registration containing the productive capacity of the undertaking and such other details as may be prescribed.

(ii) Industrial licensing : After the commencement of the Act, no person or authority (other than the Central Government and other Governments with the previous permission of the Central Government) can establish any new industrial undertaking except under, and in accordance with, a licence issued in that behalf by the Central Government. However, as stated earlier, the Government can grant exemptions in this regard.

If the Central Government is satisfied that any person or authority to whom or to which a licence has been issued under Section II, has, without reasonable cause, failed to establish or to take effective steps to establish the new industrial undertaking in respect of which the licence has been issued, within the time specified therefor or within such extended time as the Central Government may think fit to grant in any case, it may revoke the licence. The Central Government may also vary or amend any licence issued under Section II, subject to any rules that may be made in this behalf. But no such power shall be exercised after effective steps have been taken to establish the new industrial undertaking in accordance with the licence issued in this behalf.

Power to Investigate, Exercise Control, Take-over Management, etc.

The Act empowers the Central Government to make or cause to be made a full and complete investigation where it is of the opinion that in respect of any scheduled industry or undertaking, there has been, or is likely to be, an unjustifiable or a substantial fall in the output or a marked deterioration in the qualilty of the output or an unjustifiable rise in the price of the output.

If, after any such investigation, the Central Government is satisfied that action under Section 16 is desirable, it may issue such directions to the industrial undertaking or undertakings concerned as may be appropriate in the circumstances for all or any of the following purposes, namely—

(a) Regulating the production of any article or class of articles by the industrial undertaking or undertakings and fixing the standards of production;

(b) Requiring the industrial undertaking or undertakings to take such steps as the Central Government may consider necessary to stimulate the development of the industry to which the undertaking or undertakings relates or relate;

(c) Prohibiting the industrial undertaking or undertakings from resorting to any act or practice which might reduce its or their production, capacity or economic value;

(d) Controlling the prices, or regulating the distribution, of any article or class of articles which have been the subject matter of investigation.

The Act also provides that any directive of the above nature may be issued by the Central Government at any time when a case relating to any industry or industrial undertaking or undertakigns is under investigation. Such a directive shall have effect until it is amended or revoked by the Central Government.

If the industrial undertaking to which any of the abovementioned directives have been issued has failed to comply with such directives, the Central Government is empowered to authorise, by a notified order, any person or body of persons to take over the management of the whole or any part of the undertaking or to exercise in respect of the whole or any part of the undertaking such functions of control as may be specified in the order.

This Act also provides that a full and complete investigation may be made if the Central Government is of the opinion that any industrial undertaking is managed in a manner highly detrimental to the scheduled industry concerned or to the public interest. If the Central Government is satisfied, as a result of the investigation, that the industrial undertaking is managed in a manner highly detrimental to the scheduled industry concerned or to the public interest, it may authorise any person to take over the management or exercise any control as described in the preceding paragraph.

Any such notified order shall have effect for such period not exceeding five years as may be specified in the order. However, the Act also provides that, if the Central Government is of the opinion that it is expedient in the public interest that any such notified order should continue to have effect after the expiry of the period of five years aforesaid, it may, from time to time, issue a directive for such continuance for such period, not exceeding two years at a time, as may be specified in the directive, provided that the total period of such continuance (after the expiry of the said period of five years) does not exceed twelve years.

The Central Government may, by a notified order, cancel the order of taking over of the management or exercise control if at any time it appears to the Government, on the application of the owner of the industrial undertaking or otherwise, that the purpose of the order has been fulfilled or that for any other reason it is not necessary that the order should remain in force. On the cancellation of the order, the management or the control, as the case may be, of the industrial undertaking shall vest in the owner of the undertaking.

The Central Government may authorise any person to take over the management or exercise the functions of control of any undertaking if it is staisfied, in relation to the industrial undertaking, that:

(a) The persons in charge of such industrial undertaking have, by reckless investments of creation of encumbrances on the assets of the industrial undertaking, or by diversion of funds, brought about a situation which is likely to affect the production of articles manufactured or produced in the industrial undertaking and that immediate action is necessary to prevent such a situation; or

(b) It has been closed for a period of not less than three months (whether by reason of the voluntary winding up of the company owning the industrial undertaking or for any other reason) and such closure is prejudicial to the concerned scheduled industry and that the financial condition of the company owning the industrial undertaking and the condition of the plant and machinery of such undertaking are such that it is possible to restart the undertaking and such restarting is necessary in the interest of the general public.

The Act also empowers the Government to take-over the management or exercise the functions of control, with the permission of the High Court, of any undertaking owned by a company in liquidation, if it is satisfied that the running or restarting of the industrial undertaking is necessary in the public interest.

Power to Provide Relief to Certain Industrial Undertakings

We have seen above that, in certain cases, the Central Government may take-over the management or exercise the functions of control of the whole or part of an industrial undertaking. The ID&R Act empowers the Central Governemnt to provide certain relief to an industrial undertaking or any part thereof, the management or control of which has been taken over by the Government. In the interest of the general public, with a view to preventing a fall in the volume of production of any scheduled industry, it may, by a notified order, declare that—

(a) All or any of the enactment specified in the Third Schedule shall not apply or shall apply with such adaptations, to such industrial undertaking, as may be specified in the notified order [The Third Schedule to the Act includes: (i) The Industrial Employment (Standing Orders) Act, 1946; (ii) The Industrial Disputes Act, 1947; and (iii) The Minimum Wages Act, 1948).];

(b) The operation of all or any of the contracts, assurances of property, agreements, settlements, awards, standing orders or other instruments in force (to which such industrial undertaking or the company owning such undertaking is a party or which may be applicable to such industrial undertaking or company) immediately before the date of issue of such notified order shall remain suspended or that all or any of the rights, privileges, obligations and liabilities accruing or arising thereunder before the said date, shall remain suspended or shall be enforceabler with such adaptations and in such manner as may be specified in the notified order.

The notified order shall remain in force, in the first instance, for a period of one year, but the duration of such order may be extended from time to time by a further notified order by a period not exceeding one year at a time. But no such order shall remain in force after the expiry of the period for which the management of the industrial undertaking was taken over, or for more than eight years in the aggregate from the date of the issue of the first notified order, whichever is earlier.

Sale or Reconstruction

Where the management or control of an industrial undertaking has been taken over by the Central Government, it may, at any time during the continuance of such management or control, call for a report from the authorised person of the affairs and working of the industrial undertaking, and in submitting the report the authorised person shall take into account the inventory and the lists of members and creditors.

On receipt of such a report.

(a) The industrial undertaking may be sold as a running concern if the Government considers it necessary or expedient in the interest of the general public so to do; or

(b) Reconstruct the company owning the industrial undertaking if the Government is satisifed that it is necessary so to do in the interest of the general public or the shareholders, or to secure proper management of the company owning the industrial undertaking.

Price and Distribution Controls

For securing an equitable distribution and availability at a fair price of any article or class of articles relating to any scheduled industry, the Central Government may, under Section 18-G, by a notified order, provide for regulating the supply and distribution thereof and trade and commerce therein, notwithstanding anything contained in any other provision of this Act.

A notified order made in this respect may provide for --

(a) Controlling the price at which any such article, or class of articles thereof, may be bought or sold;

(b) Regulating by licences, permits, or otherwise the distribution, transport, disposal, acquisition, possession, use or comsumption of any such article or class thereof;

(c) Prohibiting the withholding from sale of any such article or class thereof ordinarily kept for sale;

(d) Requiring any person manufacturing, producing or holding in stock such article or class of articles thereof to sell the whole or a part of the artciles to such person or class of persons and in such circumstances as may be specified in the order;

  (i) where the price can, consistently with the controlled price, if any, be fixed by agreement, the price so agreed upon;

  (ii) where no such agreement can be reached, the price calculated with reference to the control price, if any, fixed under this section;

  (iii) where neither clause (i) nor clause (ii) applies, the price calculated at the market rate prevailing in the locality at that date;

(e) Regulating or prohibiting any class of commercial or financial transactions relating to such articles or class thereof which, if unregulated, are likely to be detrimental to the public interest;

(f) Requiring persons enaged in the distribution and trade and commerce in any such article or class thereof to exhibit statement of the stock and price of the articles.

(g) Collecting any information or statistics with a view to regulating or prohibiting any of the aforesaid matters; and

(h) Any incidental or supplementary matters, including in particular, the grant of issue of licences, permits or other documents and charging fees therefor.

No order made in exercise of any power conferred by this Section (18-G), shall be called in question in any court.

In this Section (18-G), the expression "article or class of articles" relatable to any scheduled industry includes any article or class of articles imported into India which is of the same nature or description as the article or class of articles manufactured or produced in the scheduled industry.

Powers of Inspection

For the purpose of ascertaining the position of working of any industrial undertakings or for any other purpose mentioned in this Act or the rules made thereunder, any person authorised by the Central Government in this behalf shall have the right to —

(i) Enter and inspect any premises;

(ii) Order the production of any document, book, register or record in the possession or power of any person having the control of, or employed in connection with, any industrial undertaking; and

(iii) Examine any person having the control of, or employed in connection with, any industrial undertaking (Sec.19).

Decision of Central Government Final on Certain Matters

Section 23 of the Act provides that, if, for the purpose of this Act, any question arises as to whether —

(i) there has been a substantial expansion of an industrial undertaking, or

(ii) an industrial undertaking is producing or manufacturing any new article,

the decision of the Central Government thereon shall be final.

INDUSTRIAL LICENSING

The Industries (Development and Regulation) Act, 1951, empowers the Central Government to regulate the establishment and certain activities of the industrial undertaking by means of licensing.

The licensing provisions of the IDRA apply to industrtial undertakings set up by any person or authority including the government.

Letter of Intent and Licence

A licence is a written permission from the government to an industrial undertaking to manufacture specified articles included in the Schedule. If a new company has to be formed, the industrial licence instance, be issued in the name of the applicant, and later when the company has been formed, the necessary endorsement to that effect will be made in the licence.

A licence contains particulars of the industrial undertaking, its location, the articles to be manufactured, its capacity on the basis of the maximum utilisation of plant and machinery, and other appropriate conditions which are enforceable under the Act. It is also subject to a validity period within which the licensed capacity should be established.

If an application for licence is approved and further clearances (such as foreign collaboration and capital goods import) are not involved and no other prior conditions have to be fulfilled, an industrial licence is issued to the applicant. In other cases, a letter of intent is issued, which will later be converted into a licence on fulfilling the conditions stipulated in the letter of intent.

In other words, a letter of intent conveys the intention of the Government to grant a licence subject to the fulfilment of certain conditions. The conditions to be fulfilled relate to the approval of foreign investment proposal, import of capital goods, application to be made to the financial institutions, taking of steps to control pollution, etc. A letter of intent enables the applicant to finalise and formulate the proposals on matters relating to the terms of foreign collaboration, import of capital equipment and/or issue of capital with the assurance that if the proposals are otherwise found satisfactory an industrial licence will be issued.

On fulfilment of the prescribed conditions, the holder of the letter of intent is required to approach the concerned administrative ministry for getting the LI converted into industrial licence.

Objectives of Licensing

Licensing is a means to help achieve some of the objectives of the industrial policy. An examination of the type of regulations exercised by licensing under the Industries (Development and Regulation) Act indicates that the obejctives of industrial licensing in India were the following:

(i) To achieve the desired pattern of industrial dispersal, particularly by promoting industries in the backward areas.

(ii) To encourage new entrepreneurs and wider dispersal of industrial ownership.

(iii) To prevent concentration of economic power.

(iv) To protect and promote the small-scale sector.

(v) To reguate foreign capital and technology.

(vi) To ensure the use of proper technology and scale economies.

(vii) To ensure control of industrial pollution.

(viii) To maintain/achieve demand-supply balance.

(ix) To encourage exports and import substitution.

(x) To ensure socio-economic and commercial viability of projects.
(xi) To conserve foreign exchange.
(xii) To support employment generation.

Activities Requiring Licence

Before the policy liberalisation announced on 24-7-91, a licence was required for the following purposes:

(i) Establishment of new undertaking : No person or authority other than the Central Government was permitted to establish any new industrial undertaking, except under and in accordance with a licence issued by the Central Government. However, a Government, other than the Central Government may with the previous permission of the Central Government, establish a new industrial undertaking.

A licence or permission to establish a new undertaking may contain such conditions including, in particular, conditions as to the location of the undertaking and the minimum standards of size to be provided therein as the Central Government may deem fit to impose in accordance with the rules in this respect.

(ii) Manufacture of new item : Licence was required for production or manufacture of a 'new article' in an existing industrial undertaking. New article means any item of manufacture in a scheduled industry other than those specified in the registration certificate or licence issued to the undertaking. It also includes any article which bears a mark as defined in the Trade Marks Act, 1940, or which is the subject of a patent if, at the date of registration or issue of the licence or permission, as the case may be, the industrial undertaking was not manufacturing or producing such article bearing that mark or which is the subject of that patent.

(iii) Substantial expansion of capacity : Licence was required for substantial expansion of the capacity of an industrial undertaking in an existing line of manufacture. Substantial expansion means the expansion of an existing industrial undertaking which substantially increase the productive capacity of the undertaking or which is of such a nature as to amount virtually to a new industrial undertaking, but does not include any such expansion as is normal to the undertaking having regard to its nature and the circumstances relating to such expansion.

(iv) Continuation of business in certain cases : An industrial undertaking to which the provision of the IDRA did not originally apply but became applicable thereafter for any reason (like cancellation of an exemption granted under the Act) should obtain a licence to carry on the business of the undertaking after the expiry of three months from the date on which the provision of the Act became so applicable. Such a licence was known as COB (carry on business) licence.

(v) Change of location : As stated earlier, the location of an industrial undertaking is specified in the licence. A change of the location so specified could not be made without the general or specific permission of the Central Government.

However, no prior permission of the Central Government was needed to shift a part or the whole of the manufacturing activity of an undertaking from a forward area to a backward area within the same State provided that the prior permission of the State Government concerned is obtained by the industrial undertaking. However, the industrial undertaking was required to inform the administrative ministry, technical authority concerned and the SIA about the change of location. The same rules were also applicable in respect to such changes of location from one notified backward area to another notified backward area within the same State.

Where an industrial licence was granted subject to the condition that the industrial undertaking would be set up only *in a no industry district*, a change of location to any other area, including a notified backward area would not normally be allowed.

Power to Revoke/Amend Licence

The Central Government is empowered to revoke the licence if it is satisfied that any person or authority to whom a licence has been issued, failed, without reasonable cause, to establish or to take effective steps to establish the new industrial undertaking, in respect of which the licence has been issued, within the time permitted. The Central Government may also vary or amend any licence issued, subject to any rules that may be made in this regard. But, no such power shall be exercised after effective steps have been taken to establish the new industrial undertaking in accordance with the licence issued.

Exemptions from Licensing

Projects involving investment upto specified limits were exempted from licensing, subject to certain conditions. This exemption limit was periodically revised upwards. Before the announcement of the new policy in July 1991, this limit was Rs. 15 crores in non-backward areas and Rs. 50 crores in backward areas.

The New Policy

The new industrial policy has abolished industrial licensing, irrespective of the levels of investment, for all industries exempt 18 specified industries which will continue to be subject to compulsory licensing for reasons related to security, strategic or environmental concerns and certain items of luxury consumption that have a high proportion of imported inputs.

The list of industries subject to compulsory licensing was further reduced to 15.

Also see chapter 9.

APPENDIX 10.1

LIST OF INDUSTRIES IN RESPECT OF WHICH INDUSTRIAL LICENSING IS COMPULSORY

(1) Coal and lignite.

(2) Petroleum (other than crude) and its distillation products.

(3) Distillation and brewing of alcoholic drinks.

(4) Sugar.

(5) Animals fats and oils.

(6) Cigars and cigarettes of tobacco and manufactured tobacco substitutes.

(7) Asbestos and abestos-based products.

(8) Plywood, decorative veneers, and other wood based products such as particle board, medium density fibre board, block board.

(9) Tanned or dressed furskins.

(10) Paper and newsprint except bagasse-based units.

(11) Electronic aerospace and defence equipment; all types.

(12) Industrial explosives including detonating fuse, safety fuse, gun powder, nitrocellulose and matches.

(13) Hazardous chemicals.

(14) Drugs and pharmaceuticals (according to drug-policy).

(15) Entertainment electronic: (VCRs, colour TVs, C.D. players, tape recorders).

Note: **The compulsory licensing provisions would not apply in respect of small-scale units taking up the manufacture of any of the above items reserved for exclusive manufacture in small-scale sector.**

(1) motor car (2) white goods' and (3) raw hides and skins and leather and patent leather which were in the list of 18 industries were subsequently delicensed.

11

Protection of Patents and Trademarks

PATENT

A patent is a monopoly right, granted by the law, to commercial use of an invention that is new and is useful and that is adequately disclosed.

Most governments have regulations to protect intellectual property rights like patents, copyrights and other protective forms governing industrial and artistic creations.

The main objective of patents protection is to encourage research and development. Patents:

(i) encourage research and invention;

(ii) induce an inventor to disclose his discoveries instead of keeping them as a secret;

(iii) offer a reward for the expenses of developing inventions to the state at which they are commercially practicable; and

(iv) provide an inducement to invest capital in new lines of production which might not appear profitable if many compete simultaneously.

The main purpose of the patent system, thus, is to benefit the society. Patents by providing an opportunity to recoup the cost of invention, which is quite substantial in many cases, and to make profit out of the invention, encourage research and development and thereby contribute to the well being of the society.

Indian Patents of Law and Uruguay Round Agreement

One of the major controversy regarding the Uruguay Round Agreement* under the General Agreement on Tariffs and Trade (proposed to be transformed into World Trade Organisation (WTO) with effect from January 1, 1995) is about the Trade Related aspects of Intellectual Property Rights (TRIPs).

---

* As the first Draft embodying the results of the Uruguay Round negotiations was presented by Arthur Dunkel, the then Director General of GATT, this came to be popularly known as the Dunkel Draft. The Final Act was agreed upon by the member countries of GATT on December 15, 1993 and was signed by 125 nations on April 15, 1994.

The TRIPs Agreement of the Uruguay Round encompasses seven areas of intellectual property rights, namely, copy rights trade marks, trade secrets, industrial designs, geographical appellations, integrated circuits and patents. It may be noted that of these seven areas, it is only in the area of patents that India's policies, laws and regulations are not in conformity with the TRIPs Agreement.

Under the Indian Patents Act, 1970, for food, pharmaceuticals and agrochemicals there is only process patent, no product patent. This means that one can produce a product similar to the patented product through a different process or method than the patented one. This practice has been very prevalent in the Indian pharmaceutical industry. Further, under the existing patent law in India, the duration of the patent protection for the above products is seven years and for other products 14 years. According to the TRIPs agreement of the Uruguay Round, there shall be both process and product patents and the period of patent protection shall be 20 years.

The fears of monopolisation and resultant sharp increase in prices if product patent is accepted seems to be exaggerated. A study shows that the patented drug segment of the Indian pharmaceutical sector is currently below 16 per cent of the total market and within this segment more than half of the drugs have other therapeutic equivalents. Extrapolation of these results of the future shows that only seven per cent of the total pharmaceutical market would constitute patented inventions with few or no substitutes.[1] Even in respect of these drugs it would not be easy to jack up prices to very high levels as Government could prevent monopoly abuse by price controls and other means. It is also pointed out that "today the lack of patent protection has made foreign firms shy away from producing most of them in India, and without any compulsion to do so, Indian companies have shown no interest in sub-licensing their manufacture. As a result, Indians forced to buy life-saving drugs like those for cancer have to pay ruinous prices. Once patent protection is available, many of the drugs now being imported will start being made here, and their prices will fall."[2]

It may also be noted that the TRIPs agreement permits public non-commercial use of a patent by the government without authorisation of the patent owner. That is, the agreement permits governments to look after the interests of the poor by making the patented drug available through government hospitals or other public institutions. Further, the agreement also provides for the selective and judicious use of compulsory licensing provisions to safeguard public interest.

The Indian Patents Act, 1970, excludes methods of agriculture and horticulture and bio-technological processes and products from patentability plants and animals other than microorganisms, and essentially biological processes for the production of plants or animals other than non-biological and micro biological processes. However, member countries shall provide for the

---

1. Jayashree Watal, "The Sunny Side", *The Economic Times*, 27 December 1993, p. 1.
2. P.S. Jha, "Drunkel Draft : The brighter side", *The Economic Times*, 25 December 1993. p. 4.

protection of plant varieties either by patents or by an effective *sui generis* system or by any combination thereof. These provisions are subject to review after four years.

It is clear that the Uruguay Round Agreement does not compel any country to extend patentability to plan varieties. Instead a country can opt for an effective *sui generis* system. There is, however, a lot of ambiguity here. The Agreement does not make clear what is meant by an effective *sui generis* system. Again, even the exact definition of the *sui generis* system is not given. Interpretations of the term range from "a system of your own" to "a system complete in itself". It is unfortunate that such serious ambiguities should be allowed to prevail in such an important agreement.

The Indian Patents Act, 1970, excludes methods of agriculture and horticulture and bio-technological processes and products from patentability. These will be patentable according to Uruguay Round Agreement.

However, contrary to the propaganda unleashed in India, the Uruguay Round Agreement does not prohibit the retaining of patented seeds for their own use. The Agreement may not also come in the way of farmers exchanging seeds among themselves.

The Uruguay Round Final Act says that a country may exclude from patentability plants and animals other than microorganisms, and essentially biological processes for the production of plants or animals other than non-biological and micro-biological processes. However, member countries shall provide for the protection of plant varieties either by patents or by an effective *sui generis* system or by any combination thereof. These provisions are subject to review after four years.

It is clear that the Uruguay Round Agreement does not compel any country to extend patentability to plant varieties. Instead, a country can opt for an effective *sui generis* system. There is, however, a lot of ambiguity here. The Agreement does not make clear what is meant by an effective *sui generis* system. Again, even the exact definition of the *sui generis* system is not given. Interpretations of the term range from "a system of your own" to "a system of your own" to "a system complete in itself". It is unfortunate that such serious ambiguities should be allowed to prevail in such an important agreement.

Government of India is proposing to bring out a *sui generis* legislation to protect plant varieties. According to Government sources, under the proposed legislation, farmer's right to retain and exchange seeds will not be affected.

TRADE MARKS

Brands and *trade marks*, used very extensively in modern marketing to maintain product identity and to help product promotion, have become very popular terms.

The definitions of some the important terms given in *Marketing Definitions: A Glossary of Marketing Terms*, published by the American Marketing Association, are given below.

Brand: A brand is a name, term, sign, symbol, or design or a combination of them, intended to identify the goods or services of one seller or group of sellers and to differentiate them from those of competitors.

Brand Name: Brand name is that part of the brand which can be vocalised — the utterable.

Brand Mark: Brand mark is that part of a brand which can be recognised but is not a utterable, such as symbol, design or distinctive colouring or lettering.

Trade Mark: A trade mark is a brand or part of a brand that is given legal protection because it is capable of exclusive appropriation. A trade mark protects the seller's exclusive rights to use the brand name and/or brand mark.

THE TRADE AND MERCHANDISE MARKS ACT, 1958

The Trade and Merchandise Marks Act, 1958, is the law governing Trade Marks in India. This Act enables the registration of trade marks so that the proprietor of the trade mark gets legal right to the exclusive use of the trade mark.

The objectives of the Act are to provide for:

(i) the registration and better protection of trade marks, and

(ii) the prevention of the use of fraudulent marks on merchandise.

The Trade and Merchandise Marks Act lays down the procedures for registration of trade marks, rights conferred by registration and the punishment for infringement of trade marks.

Meaning of Trade Mark

According to the Trade and Merchandise Marks Act, a trade mark is a mark which establishes a connection between certain goods and the proprietor or the registered user of the trade mark. It may also include a certification trade mark.

According to the definition given in the Trade and Merchandise Marks Act, 1958.

(i) in relation to chapter X* (other than see 81) trade mark means "a registered trade mark or a mark used in relation to goods for the purpose of indicating or so as to indicate a connection in the course of trade between the goods and some person having the right as a proprietor to use the mark; and

(ii) in relation to other provisions of this Act, "a mark used or proposed to be used in relation to the goods for the purpose of indicating or so as to indicate a connection in the course of trade between the goods and some person having the right, either as proprietor or registered user, to use mark whether with or without any indication of the identity of that person, and includes a certification trade mark registered as such under the provisions of the Act.

A certification trade mark means a mark adopted in relation to any goods to distinguish, in the course of trade, goods certified by any person in respect of

---

* Chapter X deals with the offences and penalties for falsifying or falsely applying trade marks.

origin, material, mode of manufacture, quality, accuracy or other characteristic, from goods not so certified and registerable as such under the provisions of the Act in respect of those goods in the name as proprietor of the certification trade mark, of that person.

Registration of Trade Marks

The Registrar of Trade Marks is the Controller General of Patents, Designs and Trade Marks appointed by the Central Government.

Under the Act, the Central Government has established a Registry known as the *Trade Marks Registry*. The Act empowers the Central government to establish branch offices of the Trade Marks Registry and to define the territorial limits within which an office of the Trade Marks Registry may exercise its functions.

A record called the Register of Trade marks shall be kept at the head office of the Trade Marks Registry. All registered trade marks with the names, addresses and descriptions of the proprietors, the names, addresses and descriptions of registered users and all other prescribed matters relating to the registered trade mark shall be entered in this Register. Every branch office of the Trade Marks Registry shall maintain copy of the Register of Trade Marks and such other specified documents.

The Register of Trade Marks is divided into two parts called Part A and Part B. Part A is for incorporating the trade marks which existed at the time of commencement of the Trade and Merchandise Marks Act, 1958, and Part B is for incorporating all trade marks registered after the commencement of this Act.

A trade mark may be registered in respect of any or all of the goods comprised in a prescribed class of goods.

To be eligible for registration, a trade mark must either be distinctive or be capable of distinguishing the goods of the applicant from those of other manufacturers or traders.

Prohibitions and Restrictions: The following types of marks are prohibited from registration. A mark —

(a) the use of which would be likely to deceive or cause confusion; or

(b) the use of which would be contrary to any law for the time being in force; or

(c) which comprises or contains scandalous or obscene matter; or

(d) which comprises or contains any matter likely to hurt the religious susceptibilities of any class or section of the citizens or India; or

(e) which would otherwise be disentitled to protection in a court.

It is also laid down in the Act that the mark applied for registration:

(i) should not be either identical or deceptively similar to existing registered trade marks and,

(ii) should not be either the same or of the same description as those of the already registered trade marks.

No word which is commonly used and accepted name of any single chemical element or single chemical compound (as distinguished from a mixture) shall be registered as a trade mark in respect of a chemical substance or preparation.

Where an application is made for the registration of a trade mark which falsely suggests a connection with any living person, or a person whose death took place within twenty years prior to the date of application for registration of the trade mark, the Registrar may require the applicant to furnish him with the consent in writing of such living person or, as the case may be, of the legal representative of the deceased person.

Disclaimer: If a trade mark (a) contains any part (i) which is not the subject of a separate application by the proprietor for registration as a trade mark; or (ii) which is not separately registered by the proprietor as a trade mark; or (b) contains any matter which is common to the trade or is otherwise of a non-distinctive character, the trade mark may be registered subject to the condition that the proprietor shall disclaim any right to the exclusive use of such part or of all or any portion of such matter.

Procedure for Registration: Application for registration of the trade mark shall be made to the Registrar of Trade Marks in the prescribed manner.

Subject to the provisions of the Trade and Merchandise Marks Act, the Registrar may refuse the application or may accept it absolutely or subject to such amendments, modifications, conditions or limitations, if any, as he may think fit. In the case of a refusal or conditional acceptance of an application, the Registrar shall record in writing the grounds for such refusal or conditional acceptance and materials used by him in arriving at his decision.

Where an application for registration of a trade mark is accepted, whether absolutely or subject to conditions or limitations, the Registrar shall cause to advertise it in the prescribed manner so that any person having any opposition to the registration of that trade mark may give notice of the opposition in the prescribed manner to the Registrar. If the Registrar receives any proper notice of opposition, he shall serve a copy of it on the applicant. On receipt of the copy of the notice, the applicant shall send to the Registrar in the prescribed manner a counter-statement of the grounds on which he relies for his application, and if he does not do so he shall be deemed to have abandoned his application. If the applicant sends such counter-statement the Registrar shall serve a copy thereof on the person giving notice of opposition. The registrar shall also give the applicant and the opponent an opportunity to be heard if they so desire. The Registrar shall, after hearing the parties, if so required, and considering the evidence, decide whether and subject to what conditions or limitations, if any, the registration is to be permitted or not. On the registration of a trade mark, the Registrar shall issue to the applicant a certificate in the prescribed form and manner.

Duration of Registration: The registration of trade mark is for a period of seven years, but may be renewed from time to time in accordance with the provisions of the Act.

Rights Conferred by Registration

Registration gives the registered proprietor an exclusive right to the use of the trade mark in relation to the goods in respect of which the trade mark is registered.

It is the registered proprietor who is also given the right to obtain relief in respect of the infringement of the trade mark.

It may be noted that no person shall be entitled to institute any proceedings to prevent or to recover damages for — the infringement of an unregistered trade mark.

It may also be noted that according to this Act, the proprietor or a registered user is not entitled to interfere with any *bona fide* use by a person of his own name or that of the name of a place of business, or any of his predecessors in business, or the use by any person of any *bona fide* description of the character or quality of his goods.

Taking advantage of the above provision, several firms have been using for their businesses the names of well known business houses in India.

Infringement of Trade Mark

The Act prohibits the infringement of trade mark in course of trade. That is, use of such a trade mark is identical with or deceptively similar to registered trade marks without the proper consent of the registered proprietor is prohibited.

Assignment and Transmission

The registered proprietor of a trade mark has the power, subject to the provisions of the Trade and Merchandise Marks Act, to assign the trade mark and to give effectual receipts for any consideration for such assignment.

A registered trade mark is assignable and transmissible, whether with or without the goodwill of the business concerned. However, an unregistered trade mark is not assignable or transmissible except along with the goodwill of the business concerned.

Registered Users

Subject to the provisions of the Trade and Merchandise Marks Act, a person other than the registered proprietor may be registered as a registered user in respect of any or all of the goods in respect of which the trade mark is registered. For registration as registered user, the registered proprietor and the proposed registered user shall jointly apply to the Registrar of Trade Marks in the prescribed manner.

What is given above is important points of some of the salient features of the Trade and Merchandise Marks Act, 1958. The Act also deals with several other matters like penalties for offences like falsifying and falsely applying trade marks, special provisions for textile goods, legal procedures and so on.

12

Industrial Development Strategy and Growth Under Indian Planning

In the last four decades or so, India has made significant progress in industrialisation, though the development has been characterised by deficiencies and lopsidedness. Large investments have been made in building up capacity over a wide spectrum of industries; and though India is still primarily an agrarian society, she is one of the major industrial powers of the world.

In the three and a half decades of industrialisation since the commencement of planning, the index of industrial production registered an eight-fold increase, and the share of the secondary sector in the Gross Domestic Product increased from about 15 per cent in 1950-51 to nearly 30 per cent now.

Apart from the quantitative increase in output, the industrial structure has been widely diversified, covering broadly the entire range of consumer. intermediate and capital goods. In most of the manufactured products, the country has achieved a large measure of self-sufficiency, providing the capability to sustain the future growth of vital sectors of the economy primarily through domestic effort. This is reflected in the commodity composition of our international trade, in which the share of imports of manufactured products has steadily declined; on the other hand, industrial products have become a growing component of our exports. Industrial development has been accompanied by a corresponding growth in technological and managerial skills, not only for the efficient operation of highly complex and sophisticated industrial enterprises but also for their planning, design and construction. Considerable advance has also been made in industrial research and absorbing, adapting and developing industrial technology.

Salient Features of Industrial Planning and Development

The salient features of planning and development of industries in India, as clear from the industrial policy statements, other policy announcements, plan documents, etc., are the following:

1. Dominance of public sector in the key industries.
2. Synchronised development of small and large industries.
3. Special assistance for the development of small industries.
4. Accelerated development of backward areas and achievement of balanced regional development.
5. Encouragement of new entrepreneurs and diffusion of onwership.
6. Prevention of concentration of economic power.
7. Achievement of self-reliance.
8. Encouragement to the cooperative sector.
9. Encouragement of import substituting and export promoting industries.
10. Balanced development of capital goods and consumer goods industries.
11. Synchronised development of industrial, agricultural and other sectors.

The development of the private sector was under strict government control. This was exercised through industrial licensing and other means. Laws like the Industries (Development and Regulation) Act and the Companies Act gave the government enormous control over the management and functioning of the industrial undertakings. The M.R.T.P. Act controlled mergers, amalgamations, takeovers etc. involving large industrial undertakings and dominant undertakings.

Control of the private sector was also sought to be exercised by giving the public sector control over the commanding heights of the economy.

The new economic policy of India, however, has removed many of the policy hurdles to the growth of the private sector and has abridged the scope of the public sector.

Capital Goods Vs. Consumer Goods

The strategy and pattern of development and the performance of the industrial sector have, however, not been free from criticism. One criticism has been that the basic and capital goods industries have been accorded a pride of place with the consumer goods being given a low priority. One school of thought maintains that, in a country like India, consumer goods industries should have been given priority to improve the living conditions of the poor by expanding employment opportunities and supply of wage goods at a faster rate. Another school emphasises the need for balanced development of the consumer goods and capital goods sectors. However, the development strategy followed by India has been complimented by a number of people on the ground that it enables the country to strengthen the industrial base and to attain self-reliance. "In the process of capital accumulation, it may be argued, certain capital-intensive, or large-scale, sectors producing non-importable commodities— the prime examples being railway transport and electricity— are bound to grow. Again, it has been argued that India cannot, at a reasonable cost, expand her imports rapidly; and that, as a consequence, the expanded production of fertilizers, dams, railways, textiles and buildings, require some domestic production of the necessary capital gods and intermediates. The response of the agricultural sector to invest may be slow and uncertain. The most promising source of saving to finance development may be the profits of the organised sector."[1] So go the arguments.

Even in the case of consumer goods, the growth of output of consumer non-durables was much slower than that of consumer durables which cater mostly to the needs of the affluent and better-off sections of society. The implication of the slow growth of consumer goods, particularly consumer non-durables, is that the common man has not so far benefited much from the type of industrial development we have had, though "the establishment of basic and heavy industries has laid the foundation for further development, contributed to the promotion of self-reliance in respect of capital goods and modern technology and incidentally helped to build up the defence strength of the country which enabled it to successfully stem the attack made by China and Pakistan."[2]

The "heavy industry" strategy of the *Mahalanobis model* was initiated in the Second Plan. The Mahalanobis model purports that, for the attainment of a self-reliant and self-sustained growth, it is imperative that India should build up its own basic and capital goods industries for which the country has intrinsic comparative advantage by virtue of possessing the required natural resource base. In an economy constrained by resource scarcity, the Mahalanobis model requires severe curbs on the development of consumption goods industries to make resources available for the growth of the capital goods industries. The restraint on consumption is considered to be a necessary and worthwhile sacrifice in the interests of building up a large enough capital base to provide significant increments in output in the long run. "The restrictions on consumption envisaged relate to industries producing luxury goods and

---

1. James Mirrlees, "Targets and Investments in Industry." in Paul Streeten and Michael Lipton, (Ed.), *The Crisis of Indian Planning* (Bombay : Oxford University Press, 1968), p.63.

2. A P Srinivasamurthy, *Investment Allocation in Indian Planning* (Bombay: Himalaya Publishing House, 1981), p. 311.

relatively inessential consumer goods and also to having a large variety within each type of consumer goods. These restrictions are to be imposed by an appropriate use of various policy instruments, such as licensing, allocation of foreign exchange and other resources, and promoting the standardisation of consumer articles, etc. The success of heavy industry strategy depended, *inter alia*, very much on these regulatory devices being effectively used. Experience has shown that the mechanism of industrial control and regulation was not quite successfully operated, and that this has also been admitted by the Planning Commission itself."[3]

The bias in favour of the capital goods industries has contributed to the inflationary pressure because these industries involve heavy investments and long gestation periods. Further, the "heavy industry strategy would have probably produced better results if it had not been accompanied by a relative indifference towards the problems of a quick agricultural transformation and the rural requirements, thereby keeping a very big segment of the economy outside the full impact of development planning. What this neglect has meant is now widely known. The shortfalls in agricultrual production have, time and again, jeopardised the smooth progress of industrial development itself. Besides causing shortages in the supplies of foodgrains and raw materials, they also prevented the demand for the products of industry from growing adequately, thereby aggravating the chronic problem of under-utilisation of capacity in industry."[4]

An appraisal of the chosen industrial plan strategy of imbalance between capital goods and consumption goods industries in favour of the former lead to the following conclusions:[5]

(i) It was not efficiently implemented;

(ii) It had inherent weaknesses against which corrective measures were not taken;

(iii) It was not fully planned, and did not take note of the choices within the capital goods and of the dynamic need for a gradual shift towards a better balance between the two categories; and

(iv) It had not the wider support of adequate agricultural development.

A recognition of several of these weaknesses of the earlier approach to industrial development has, since the Fifth Plan, led to a change in approach.

Roles of Public and Private Sectors

Another controversial aspect has been the relative roles of the private and public sectors. Over the years, the public sector has attained a dominant position in the critical and key sectors. Apart from its performnce, the expansion of the public sector has been objected on ideological grounds. However, the crucial role of the public sector in a developing country like India has been widely recognised.

---

[3] *Ibid.*, p. 309.

[4] *Ibid.*, p. 309.

[5] *Ibid.*, p. 310.

The growth and performance of the private sector have been regulated in a number of ways. It is interesting to note that while, on the one hand, there was criticism on the ground that the private sector, especially the large industrial houses sector, was given enormous opportunities for growth and expansion, on the other hand, it was argued that the dominant role assigned to the public sector and the numerous checks and controls on the private sector retarded the pace of development.

With the Industrial Policy Resolution of 1956, the future development of 17 key industries became the exclusive responsibility of the State, and in another 12 important industries, the state was to play an active role. Further, the state had the power to enter any other industry.

Central Government investment in industrial enterprises increased substantially in the four decades since the commencement of planning. The public sector also took over a number of sick units from the private sector because of the social obligations of protecting employment. The National Textile Corporation (NTC) has under it a number of units which were taken over because they were sick.

As a corollary to its growth, the share of the public sector in the value added in mining and manufacturing (organised sector) has grown very substantially over the decades. The development of the public sector has been an import element in the drive for industrial diversification; and in industries like steel, non-ferrous metals, petroleum, fertilisers, petro-chemicals and heavy engineering, the public sector units play a dominant role.

The role of the large houses in the private sector was confined, by and large, to the core and heavy investment sectors. They were also been expected to make a significant contribution to the development of the backward areas, particularly to "no industry districts," and to the development of the export sector. The positive role of the private sector in the industrial development of the country was, thus recognised.

There has also been an emphasis on the role of the co-operative sector. The co-operative sector has made progress in industries like sugar, cotton textiles and fertilizer. Indeed, in the sugar industry, units in the co-operative sector account for over half of the total production. The growth of this sector is expected to promote industrial democracy and discourage concentration of economic power in a few hands.

The joint sector has been promoted to facilitate the utilisation of the resources and talents of the private sector and function with the social orientation of the public sector.

The new economic policy of India is characterised by a redefinition of the roles of the public and private sectors. The essential feature is an abridgement of the role of the public sector and a substantial expansion of the scope of the private sector. Accordingly:

(i) The role of the public sector would be confined mainly to areas where investment is of an infrastructural nature and where private participation is not forthcoming to an adequate extent within reasonable time. Thus, the public sector will continue to play a dominant role in areas like energy, transport, communications and irrigation. However, if private initiative comes forward to participate in creating such infrastructure on reasonable terms, including full protection of people's interests, such initiatives would be encouraged.

(ii) The public sector would play a useful role in augmenting basic resources of the country like land, forest, water, ecology and science and technology. The public sector will have responsibility for meeting social needs and for regulation of long term interests of the society like population control, health, education, etc.

(iii) In large part of its operations where commodities or services are produced and distributed, the principle of market would be applied as basic operating guidelines, unless it is necessary to protect the interests of the poorest in the society. This implies recovery of costs and efficiency in operations.

Village and Small Industries

The plan documents and policy statements on industrialisation have emphasised the importance of village and small industries. But it has been felt that "the outlays made under the plans for village and small industries were not commensurate with the importance which these industries deserved in the Indian situation".[6] A noticeable feature of the early trends in the allocation for industries is the big increase in the outlays from the First Plan to the Second Plan. "For small industries, the outlays has increased from 2 per cent of the total public sector outlay in the First Plan to 4 per cent in the Second Plan, and for the large-scale sector the increase has been spectacular, showing an increase from only 4 per cent to 20 per cent. In the subsequent plan periods, i.e., from the Third Plan onwards, while this percentage share has progressively declined in the case of small and village industries (2.8 per cent, 1.9 per cent, 1.5 per cent, 1.4 per cent respectively), in the case of the large-scale sector, except for the decline to about 18 per cent in the Fourth Plan, the percentage has shown an increase in the other plan periods (20.1 per cent, 22.8 per cent, 18.2 per cent and 25.6 per cent). These trends are noteworthy as indicating a relative decline in the emphasis on village and small industries in the alloction of plan outlays in the public sector as compared with the emphasis on the large-scale industries sector. Even if we consider the trends in the absolute amount allocated to the small-scale sector, this decline in the emphasis on village and small industries in the allocation of public sector as compared to the large-scale industries sector becomes evident .... On the whole, the above analysis leads to the conclusion that the professed importance of small-scale and village industries sector in the statement of objectives, the industrial policy and the priorities has not been reflected in the trend of allocations of the plan outlays in the public sector."[7]

---

[6] *Ibid.*, p. 299.

Comparative Cost Dynamics

One of the criticisms levelled against the development strategy in India is that the agricultural sector should have been given greater importance than industry. "When India and several other newly-emerged independent nations made a bid for rapid industrialization after the Second World War, the Western nations looked upon this more as being generally contrary to the comparative cost advantages. But very soon India's claims to become an industrial power based on a dynamic interpretation of comparative cost advantage were widely recognized. With the rich and variegated mineral agricultural resource base, the high potential for power generation, the ability of the people to acquire and absorb modern technology and a potentially expanding market for manufactures—both domestic and foreign—very few today dispute India's innate ability to develop as a big industrial power in the world."[8]

Import Substitution and Export Contribution

Import substitution assumed importance after the Second Plan. Industries with a potential for import substitution have been given great importance. At the beginning of the planning era, India relied very heavily on foreign sources of supply for the requirements of capital goods and a number of basic and other important inputs. In the last four decades, however, considerable import substitution has taken place in many important areas—in capital goods, organic chemicals, pharmaceuticals, dye-stuffs, etc.

However, the manner in which the policy of import substitution has been carried forward has been subject to criticism. For example, it has been argued that, "in the Indian context, the emphasis on import substitution has often run counter to the objective of technology development."

The diversification achieved in the industrial sector is reflected in the changing structure of the country's exports. Mention has been made about priority for industries which help exports only in the priority list of the Fifth Plan onwards, and *not* in those of the earlier plans. However, the Export Policy Resolution of 1970 emphasised the importance of continuous development and expansion of export-oriented production. The share of manufactured products in India's exports has increased significantly.

---

[7] *Ibid.*, p. 299.

[8] *Ibid.*, p. 269.

Capacity Utilisation

The importance of fully utilising the installed capacity needs no emphasis. Under-utilisation of capacity not only amounts to wastage of scarce resources but also leads to cost-push inflation. It may also create a demand-supply imbalance and affect the balance of trade, employment, savings and investment. Though only the First Plan gave top priority to the fuller utilisation of pre-existing capacity, all other five-year plans included it in the list of priorities. However, capacity utilisation in general has been quite unsatisfactory throughout the plan period.

Of course, some degree of under-utilisation of industrial capacity due to such factors as "planned excess capacity" calculated to meet the demand in the foreseeable future; technological "indivisibilities," which may inevitably create capacity in excess of that warranted by present demand; and initial "testing" troubles of new industries inescapable in the developing economy may have to be accepted as a normal feature. But India's almost chronic excess industrial capacity should be regarded as something that is due to more fundamental causes, which were not correctly appreciated in Indian Planning.[9] Input shortages, infrastructural bottlenecks and demand problems have been mainly responsible for low capacity utilisation. Improvements in capacity utilisation will, therefore, depend generation. The developments in the infrastructural sector, input supplies and demand generation. The development of the agricultural sector is important from the point of view of improving input supplies as well as demand generation.

Regional Disparities

The removal of regional disparities has assumed particular importance since the Third Plan. Large public sector industrial investments have been made in the backward States of Madhya Pradesh, Bihar and Orissa. Incentive schemes have been introduced, particularly since the Fourth Plan, to lure private sector enterprises to backward areas. However, much headway could not be made in this direction. For details, see Chapter 36.

An Evaluation

Despite several problems, the industrial sector of India has made commendable achievements in several respects. One would agree with the following observations made by the Seventh Five Year Plan document reviewing the industrial development after independence: "There has been substantial driversification of the industrial base with the consequent ability now to produce a very broad range of industrial products. Substantial self-reliance has been achieved in basic and capital goods industries which now account for as much as one half of the total value added in manufacturing. Indigenous capacities have been established to the point to virtual self-sufficiency so that further expansion in various sectors, such as mining, irrigation, power, transport and communications can be based primarily on indigenous equipment.

---

[9] *Ibid.*, p. 323.

The process of industrialisation has also fostered entrepreneurship and the development of a wide variety of technical, managerial and operative skills. This less visible but critical investment in knowledge places India as a country with one of the largest pools of skilled manpower in the developing world.

The task of achieving the multiple objectives of industrial planning, however, has not been without frustration. The principal failures of planning relate to the inability to utilise the growing potential of the industrial sector and inadequate attention paid to reducing costs and improving quality.

One of the principal achievements has been the creation of capacity in the basic and heavy industries.

In the last four decades or so, the industrial output grew at a rate (about 5.5 per cent per annum on an average) much higher than those for agricultural production about (2.6 per cent) and national income about (3.5 per cent). However, industrial growth lagged very much behind the plan targets. Further, industrial growth in India has been poor compared to several developing countries and her share in the total manufactured output and manuactured exports of developing countries declined very remarkably.

During 1951-1965, the index of industrial production registered an impressive growth rate of 7.2 per annum. During 1966-75 this rate dipped to about 4 per cent. In fact, if we exclude mining, quarrying and electricity from the index, and look at the figures for manufacturing, the decline in growth has been steeper, falling from 7.1 per cent durng 1951-65 to 3.7 per cent during 1966-75. Although there was a general recovery of the growth rate in the next decade it was still unipressive. The rate of growth of industrial production during the Sixth Plan (1980-85) was only about 5.5 per cent. During the Seventh Plan, the industrial growth rate was 8.5 per cent per annum.

In the initial years of planning industrial development was largely based on import substitution and had the advantage of a captive market. A steady growth could, thus, be maintained. Thereafter, the growth in industrial production was conditioned by the general pace of economic development in the country. It may be noted that during 1966-68 industrial growth rate approached near stagnation. The severe drought was mainly responsible for this.

It has been pointed out that the deceleration in the public investment has also contributed to slow down in industrial growth after the mid fifties.

Some authors also argue that the industrial recovery of the recent period has been supported also by the spurt in the non-developmental expenditures.

Industrial growth in India has been severely hampered by such factors as infrastructural bottlenecks, raw material shortage, disturbed industrial relations, etc.

Another important feature of industrial growth in India is that the growth of the consumer goods sector consistantly lagged behind those of the basic, capital goods and intermediate goods sectors.

One of the serious problems afflicting the industrial sector in India is the growing sickness in the small, medium and large sectors. Some of the government policies have also contributed to industrial sickness. Further, sometimes the attitude of the labour, government and financial institutions which does not allow a unit to take measures, before it becomes sick, to strengthen itself also may cause sickness. Rehabilitation packages suggested by the Board for Industrial and Financial Reconstruction (BIFR) set up under the Sick Industrial Companies (Special Provisions) Act, 1985, include such measures as closing down certain divisions or lines of business, modernisation, rationalisation, redeployment of labour force, sale of assets to generate funds, etc. The pity, however, is that a unit which proposes to take such measures before it becomes sick may have to face opposition from the trade union and even from the government/government agencies. And there will be suggestions to take such measures, offer of concessions and the like after the catastrophe has ushered in. Further, the swiftness with which the administrative machinery responds to a grave problem is indicated by the fact that it took three years to establish the BIFR after the Tiwari Committee recommended such a measure!

The small-scale sector has been given considerable importance in India. It is high time a proper social cost benefit analysis of the promotion of small-scale units vis-a-vis medium and large units is made. The promotion of small-scale units involves heavy social costs. Besides the costs of various subsidies like concessional finance and the loss arising out of tax concessions, the price preference granted to small-scale sector in government purchase increases the loss to the exchequer. Another very important factor to be noted is the generally poor condition of the labour in this sector. When compared to the workers in the organised sector, the wages and other benefits available to the workers in the unorganised sector is meagre. The rationale of employment generation in the small-scale sector at the expenses of it in the organised sector, therefore, needs a serious evaluation.

The negative effects of controls and several other problems like infrastructural bottlenecks, raw material shortages, etc. have slowed down industrial growth in India. The inefficiency of the public sector, which occupies a commanding height in the key sectors has also contributed in large measure to the poor industrial performance. Had the government taken the assistance of the private sector to supplement its efforts in crucial sectors, using the flexibility incorporated in the Industrial Policy Resolution, the performance of the infrastructural sector and some other important industries would have been much better.

Recent industrial policy liberalisations or deregulations are a reflection of the government's realisation of the counter-productive effects many of the regulations have had. The statement of the Chairman of a large industrial house in India belonging to a multinational conglomerate that earlier businessmen used to go to Delhi with bended kness to protect their monopolies and interests but now they have to go with bended knees to the consumers is an indication of the impact of the liberalisations.

Growth is a pre-requisite for achieving social justice. Optimum utilisation of the resources, including the technical and managerial skill, should be accorded a very high priority in a resource-scarce economy.

Industry in the VIII Plan

The private sector is expected to play an increasing role in industrial activities, especially where security and strategic or social considerations are not very important. The public sector will concentrate increasingly on basic and core sectors. Even in these areas, emphasis will be on financing industrial and mineral projects primarily through internal and other extra-budgetary resources instead of depending on budgetary allocations. This is in line with the general philosophy of placing greater reliance on competitiveness of industries and efficiency of operations. The undertakings which are in a position to finance their development plans on their own will be allowed greater freedom for growth and diversification as a self-sustaining process. In the case of undertakings which are operating in core areas and are largely dependent on budgetary support, limited support will be provided in the initial years to enable them to stand on their own in the later years of the Plan.

As a result of the recent policy reforms, the industrial sector is expected to undergo considerable restructuring. First, in the past there has been considerable stress on import substitution at any cost. With the emphasis now being laid on competitiveness, future growth will be more in those sectors where the country has comparative advantage. Secondly, the size of individual companies, which is very low by international standards, not a single Indian company figures in the list of first 500 'Fortune' companies, is expected to grow through expansions, amalgamations, mergers, etc. Thirdly, there would be greater integration of indigenous production with outside. Those components/sub-assemblies whose production is uneconomic, will be imported. On the other hand, some other components/sub-assemblies/

finished products will be increasingly exported. Finally, there will be joint ventures abroad to exploit the complementarities of resource endowments in this country and the concerned foreign country.

The overall outlay envisaged in the Eighth Plan for Industrial and Mineral Programmes in the public sector, is about Rs. 40,673 crores of which Rs. 35,150 crores are for the Central sector and the balance of Rs. 5,523 crores is for the State sector. Mining and manufacturing are estimated to get over 28 per cent of the gross investment during the VIII Plan.

The output of the mining and manufacturing sector is estimated to grow at an average annual rate of 8 per cent during the Eighth Plan compared to the proposed average annual growth rate of the economy of 5.6 per cent.

13

Public, Private, Joint and Co-operative Sectors

The mixed economy of India is characterised by the co-existence of public, private, joint and co-operative sectors.

PUBLIC SECTOR

The objective of accelerating the pace of economic development and the political ideology have led to rapid growth of the state owned enterprises (SOEs) sector in India.

As the Bureau of Public Enterprises observes, "born as the outcome of the concious policy of the government to speed up the industrialisation of the country with a view to give added impetus to eonomic growth as well as to achieve certain socio-economic goals as enunciated in the Industrial Policy Resolutions of the government, these enterprises today cover a wide spectrum of activities in basic and strategic industries like steel, coal, minerals and metals, petroleum, heavy engineering, chemicals, fertilizers and pharmaceuticals etc. on the one hand, and consumer goods, trading and marketing activities, transportation services, contracts and consultancy services, tourist services, financial services, development of small industries etc. on the other. While some of these enterprises operate under monopoly/near monopoly conditions, there are others working under competitive conditions. There is yet another segment of the public enterprises viz., sick enterprises taken over from private sector to protect employment. Thus, public enterprises comprise of units engaged in different spheres of industrial and commercial activities; some capital intensive — long gestation — low profitability enterprises; some sick and hence requiring special treatment; while some others are low-risk high profitability enterprises. Added to this basic diversity in the composition of the units is the multi-dimensional objectives of public enterprises in general which is another significant factor to be considered while making any realistic analysis of their performance".[1]

Objectives

As the BPE Survey referred to above states, public enterprises which are also an instrument for implementation of the government's socio-economic policies, have a multitude of objectives set for them, viz.,

(i) to help in the rapid economic growth and industrialisation of the country and create the necessary infrastructure for economic development;

(ii) to earn return on investment and thus generate resources for development;

(iii) to promote redistribution of income and wealth;

(iv) to create employment opportunities;

(v) to promote balanced regional development;

(vi) to assist the development of small-scale and ancillary industries; and

(vii) to promote import substitution, save and earn foreign exchange for the economy.

Growth of Public Enterprises

There has been a phenomenal growth of the Central Government enterprises since the commencement of planning. In fact, even before the commencement of planning and the adoption of the goal of the "socialist" pattern of society, the public sector was assigned a very important role in the industrialisation and economic development of the country. The *Industrial Policy Resolution of 1948* made it very clear that the manufacture of arms and ammunition, the production and control of atomic energy, and the ownership and management of railway transport would be the exclusive monopoly of the Central Government. It was resolved further that in another six industries the state alone would set up new undertakings. These six industries were: coal, iron and steel, aircraft manufacture, ship-building, manufacture of telephone, telegraph and wireless apparatus, excluding radio receiving sets, and mineral oils.

The *Industrial Policy Resolution of 1956* enlarged the role of the public sector. It stated: "The adoption of the socialist pattern of society as a national objective as well as the need for planned and rapid development require that all industries of basic and strategic importance, or in the nature of public utility services, should be in the public sector. Other industries which are essential and require investment on a scale which only the State, in present circumstances, could provide, have also to be in the public sector. The state has, therefore, to assume direct responsibility for the future development of industries over a wide area". Schedule A to the Resolution enumerated 17 industries, the future development of which would be the exclusive right of the state. This Schedule A is reproduced below:

---

[1] Bureau of Public Enterprises, *Public Enterprises Survey 1983-84*.

Schedule A

(i) Arms and ammunition and allied items of defence equipment.
(ii) Atomic energy.
(iii) Iron and steel.
(iv) Heavy castings and forgings of iron and steel.
(v) Heavy plant and machinery required for iron and steel production, for mining, for machine tool manufacture and for such other basic industries as may be specified by the Central Government.
(vi) Heavy electrical plant, including large hydraulic and steam turbines.
(vii) Coal and lignite.
(viii) Mineral oils.
(ix) Mining of iron ore, manganese ore, chrome ore, gypsum, sulphur, gold and diamonds.
(x) Mining and processing of copper, lead, zinc, tin, molybdenum and wolfram.
(xi) Minerals specified in the Schedule to the Atomic Energy (Control of Production and Use) Order, 1953.
(xii) Aircraft.
(xiii) Air transport.
(xiv) Railway transport.
(xv) Ship-building.
(xvi) Telephone and telephone cables, telegraph and wireless apparatus (excluding radio receiving sets).
(xvii) Generation and distribution of electricity.

Schedule B to the Industrial Policy Resolution, 1956, contained a list of 12 industries which would be progressively state-owned and in which the state would, therefore, generally take the initiative in establishing new units.

Schedule B

(i) All other minerals, except "minor minerals", as defined in Section B of the Minerals Concession Rules, 1949.
(ii) Aluminium and other non-ferrous metals not included in Schedule 'A'.
(iii) Machine tools

(iv) Ferro alloy and tool steels.

(v) Basic and intermediate products required by chemical industries such as the manufacture of drugs, dye-stuffs and plastics.

(vi) Antibiotics and other essential drugs.

(vii) Fertilizers.

(viii) Synthetic rubber.

(ix) Carbonisation of coal.

(x) Chemical pulp.

(xi) Road transport.

(xii) Sea transport.

The Central Government's investment in industrial enterprises increased from Rs. 29 crores spread over 5 units at the commencement of the First Plan (1951) to Rs. 159, 307 crores in 240 units at the end of March 1994.

GROWTH OF PUBLIC ENTERPRISES

	Total Investment (Rs. in crores)	*Number of Enterprises*
1. At the commencement of 1st Plan (1-4-1951)	29	5
2. At the commencement of 2nd Plan (1-4-1956)	81	21
3. At the commencement of 3rd Plan (1-4-1961)	953	48
4. At the commencement of 4th Plan (1-4-1969)	3,902	85
5. At the commencement of 5th Plan (1-4-1974)	6,237	122
6. At the commencement of 6th Plan (1-4-1980)	18,225	186
7. At the commencement of 7th Plan (1-4-1985)	42,811	221
8. At the commencement of 8th Plan (1-4-1992)	1,18,492	237

More than half of the total investment was of the steel, coal, minerals and metals, power and petroleum sectors.

The four decades since the commencement of planning witnessed a substantial growth and expansion of the public sector in India. Investment in industrial undertaking by the Central government increased from Rs. 29 crores in five units in 1951 to over 1.18 lakh crores spread over 237 units (operating) at the commencement of the Eighth Plan. At the end of March 1994 there were 240 central public sector enterprises (PSEs) excluding enterprises which have not become operational and excluding 8 companies with Central government investment but without direct responsibility for management, 6 insurance companies and 3 financial institutions. Of these 9 were in the construction sector, 72 in services and 165 were engaged in manufacture.

There were also about 1100 State level public enterprises (SLPEs) with an estimated investment of about Rs. 50,000 crores. The Central PSEs included departmental undertakings (e.g., railways, post and telecommunications), financial institutions (like the public sector banks, IFCI, UTI, IDBI etc.), and non-departmental undertakings or government companies incorporated under the Company Law (e.g., the Steel Authority of India and the Indian Petrochemicals Corporation Ltd.) or corporations statutorily created by Acts of Parliament (e.g., Coal India, Air India, Indian Air Lines and the National Thermal Power Corporation).

Non-departmental enterprises accounted for about 75 per cent of the value addition, more than 50 per cent of gross investment and about a third of the total employment in public sector enterprises (PSEs). PSEs contributed the entire output in the case of petroleum, lignite, copper and primary lead, about 98 of Zinc, with over 90 per cent of coal, more than half of steel and aluminium and about one-third of fertilizers.

The public sector, thus, came to occupy a commanding position in a number of industries.

While setting up of new enterprises was mainly responsible for the fast growth of the public sector, nationalisation of certain industries like coal, copper, insurances, major part of commercial banking sector and a number of sick units has also contributed to this growth.

A significant feature of the public sector investment is the predominance of investment in few crucial sectors, namely, steel, minerals and metals, petroleum, coal and chemicals and fertilizers.

The *Economic Survey, 1992-93* notes that over the decades the production activities of the PSEs has become perhaps over-diversified and extends from steel making and oil refining to manufacture of bread and footwear. This was the result of a number of circumstances and diluted the original strategic and commanding heigh objectives of PSE activity. Infrastructural or producer services are dominated by public sector corporations in transport, energy and communications. PSEs also operate in diverse service sectors such as international trade, consultancy, contract and construction services, hotels and tourist facilities, etc.

The public sector certainly had a very important role to play in the development of this vast and populous developing economy characterised by dearth of capital, entrepreneurship and technology. However, keeping the private sector completely out of many industries and giving the private sector only a secondary role in many other industries have had severe adverse effects on growth and competition. The new economic policy, characterised by scope for a substantial privatisation, including dereservation of industries for the public sector, in fact amounts to an acceptance of this.

The performance of many public enterprises has been far from satisfactory. One can, of course, speak of the contribution of the public sector towards GDP, employment generation, exports etc. The pertinent question, however, is have these contributions been adequate when compared to the massive investments that have gone into the PSEs and at what level of efficiency these enterprises have been operating. Further, to what extent these enterprises, particularly the monopolies, have been customer friendly?

A large number of PSEs, including several monopolies, have been making huge losses causing severe resource constraints in the face of the very large revenue, budgetary and fiscal deficits which the nation has been facing. Despite the huge losses incurred by a number of enterprises, the PSEs as a whole could make profits mainly because of the enormous profits made by several public sector monopolies.

Several of the loss making PSEs are either in non-priority sectors or in sectors where the private sector has proved to be more efficient. A number of loss making units are sick units.

A variety of factors have been identified for the unsatisfactory performance of a large number of public enterprises. While the project formulation has improved over the years, huge cost and time over-runs continue to take place in project implementation. This is on account of problems of land qcquisition, procurement of equipment, civil work and other imponderables. Further, the locational and investment decisions in some sectors and projects are observed to have adversely affected performance. It has been noticed that inappropriate location (e.g., Nagaland Paper Project), inappropriate technology (e.g., Surgical Instruments Plant of IDPL), irrational product-mix (e.g., Salem Steel Plant) and imposed marketing arrangements (e.g., Kundremukh Iron Ore Project) have critically affected the performance of some projects. In the fertiliser sector, choice of technology having been tied to availability of foreign financing has adversely affected their operations.

On the other hand, in power sector, excessive investment in generation capacities with incommensurate attention to transmission networks had created serious imbalances. Uneconomical pricing/tariff rates signifying large cross-subsidies have reduced the internal resource generation in this sector. This has direct implications for reinvestment on the one hand, and raises demand for power, on the other. These have also contributed, among other things, to the heavy losses incurred by most of the State Electricity Boards (in 1991-92 this was over 14 per cent of the total anticipated annual plan outlay of all States and Union Territories) which have continuously failed to realise the three per cent statutory rate of return on assets.

A number of other problems including allocation of resources, delays in the filling up of top-level posts, tight regulations and procedures for investment and restrictions on functional autonomy of the enterprises (e.g., in respect of labour and wage policy), etc. have for long been noticed as serious constraints on PSE operational efficiency.

The New Public Sector Policy

After the initial exuberance of the public sector entering new areas of industrial and technical competence, a number of problems have begun to manifest themselves in many of the public enterprises. Serious problems have observed in the insufficient growth in productivity, poor project management, over-manning, lack of continuous technological upgradation and inadequate attention to R & D and human resource development. The low rate of return on capital invested has inhibited the ability of the public enterprises to regenerate themselves in terms of new investments as well as in new technology development. This resulted in many of the public enterprises becoming a burden rather than an asset to the Government.

It has, therefore, been decided to redefine the role of the public sector. According to the new industrial policy announced on 24-7-1991, the priority areas for growth of public enterprises in future will be the following: (a) Essential infrastructure goods and services. (b) Exploration and exploitation of oil and mineral resources. (c) Technology development and building of manufacturing capabilities in areas which are crucial in the long term development of the economy where private sector investment is inadequate. (d) Manufacture of products where strategic considerations predominate such as defence equipment.

The number of industries reserved for the public sector was pruned to 8. These 8 industries were: (i) Arms and ammunition and allied items of defence equipment, defence aircraft and warships. (ii) Atomic energy. (iii) Coal and lignite. (iv) Mineral oils. (v) Mining of iron ore, manganese ore, chrome ore, gypsum, sulphur, gold and diamond. (vi) Mining of copper, lead, zinc, tin, molybdenum wolfarm. (vii) Minerals specified in the schedule to the Atomic Energy (control of production of use) Order, 1958. (viii) Railways transport. Industries (v) and (vi) were dereserved later, reducing the number to six.

The new industrial policy which abolishes the public sector monopoly in several industries is a significant step towards privatisation. Industries which are thus opened for the private sector include iron and steel; power; ship building; telephone and telephone cables, telegraph and wireless apparatus; aircraft; air transport; and, heavy plant and machinery. Further, the scrapping of the schedule B which contained a list of 12 industries where public sector was to play a dominant role is also an important policy change.

It has been reported that the Government is thinking of throwing open to the private sector most of the industries reserved for the public sector according to the industrial policy announced on July 24, 1991, except arms and ammunition and allied items of defence equipment; atomic energy; and, minerals specified in the Schedule to the atomic energy. In the other words, the policy is to abolish the monopoly of any sector or any individual enterprise in the field of manufacture, except on strategic or military considerations, and open all manufacturing activity to competition.

Further, the Central Government is also reported to be reviewing the existing portfolio of public investment with a view to offloading public investment from areas where the following conditions prevail:

(i) industries based on low technology;

(ii) small-scale and non-strategic areas;

(iii) inefficient and unproductive areas;

(iv) areas with low or zero social responsibility or public purpose; and

(v) areas where private sector has developed sufficient enterprise and resources.

The Policy statement makes it clear that the Government will ensure that the public sector is run on business lines as envisaged by in the industrial Policy Resolution of 1956.

The new policy proposes to bring sick public sector units under the Board for Industrial and Financial Reconstruction or a separate body that may be created on the lines of the BIFR to deal exclusively with sick public sector units. It has also been announced recently that unviable sick public sector units will be closed down.

The new public sector policy marks a much needed change for accelerating the pace of development by better utilisation of the national resources (including entrepreneural resources) and for increasing competition and efficiency.

The New Industrial Policy statement observes that in the 1950s and 1960s, the principal instruments for controlling commanding heights of the economy was investment in key industries. Today, the State has other instruments of intervention, particularly fiscal and monetary instruments. The State also commands the bulk of the nations savings. Banks and financial institutions are under control. Where state intervention is necessary these instruments will prove more effective and decisive.

VIII Plan Strategies

As pointed out above, the new economic policy has substanially reduced the scope of the public sector. The Eighth Five Year Plan, thus, operates under a significantly redefined public sector policy and development strategy. The emphasis in the VIII Plan is on the performance improvement of the PSEs.

The Plan Document enumerates the following policy initiatives in this regard:

(i) Restructuring involving modernisation, rationalisation of capacity, product-mix changes and selective exist and privatisation.

(ii) Increase in autonomy and performance accountability through an effective system of MOUs between administrative ministeries and public enterprises launched since the Seventh Five Year Plan.

(iii) Changes in management in specific enterprises to promote leadership, resourcefulness and innovation.

(iv) A major effort by the State Governments to streamline the working of their public sector enterprises which are beset with interference and adhoc investment and employment decisions.

(v) Technological upgradation through an integrated R and D effort and import of technology.

(vi) Re-orientation of approach in Ministeries and other Government agencies corresponding to liberalisation and dismantling of regulations (price, distribution, investment and import controls) to develop a new institutional capability to facilitate operation of market forces, orchestrisation of integrated R and D effort and evolution of consensus and partnership among various stakeholders.

ORGANISATION OF PUBLIC ENTERPRISES

Public enterprises in India have been organised in the following forms:

Ministry

For the management of the Indian Railways, there is a fullfledged Ministry of Railways in the Government of India. The Ministry of Railways undertakes and manages all the investments and enterprises connected with the railway transport of the country, and has its own Annual Budget which has to be presented to Parliament and approved by it. The Ministry has a Minister for Railways and the body of management consists of the Railway Board, headed by a Chairman. Besides the Chairman, the Board has three members and a Financial Commissioner. All these five personnel have the status of secretary to the Government of India.

-Departmental Undertakings

The Study Team on Public Sector Undertakings has mentioned the following as the principal characteristics of Departmental Undertakings[2]:

(a) It is financed by annual appropriations from the treasury and all, or a major share, of its revenues are paid into the treasury;

(b) It is subject to the budget, accounting and audit controls applicable to government activities;

(c) Its permanent staff consists of civil servants, and their conditions of recruitment and service are the same as for other civil servants; and

(d) It can be sued only by following the procedure prescribed for filing suits against the government.

The Departmental Undertaking is directly subordinate to a Ministry. The need for secrecy, strategic importance and similar conditions make the departmental form the most suitable form of organisation in certain areas (for defence industry). The ordnance factories, such as the Army Clothing Factory, the Harness and Saddlery Factory, the Gun Carriage Factory and the Ishapore Ordnance Factory under the Ministry of Defence; the Chittaranjan Locomotive Works and the Integral Coach Factory under the Ministry of Railways; and the Posts and Telegraphs under the Ministry of Communications are examples of the departmental form of organisation and management.

While the departmental system ensures effective government control, it suffers from a number of disadvantages, such as too much governmental and political interference, lack of authority and initiative in decision-making, etc.

Government Company

The principal characteristics of the Government Company, as mentioned by the Study Team on Public Sector Undertakings, are the following[3]:

(a) It has most of the features of a private limited company;

(b) The whole of the capital stock, or 51 per cent or over of it, is owned by the government;

(c) All the directors, or a majority of them, are appointed by the government, depending upon the extent to which private capital is participating in the enterprise;

(d) It is a body corporate created under a general law, viz., the Companies Act;

(e) It can sue and be sued, enter into contract, and acquire property in its own name;

---

[2] Administrative Reforms Commission, *Report of the Study Team on Public Sector Undertakings* (New Delhi: Manager of Publications (1967), p.10.

[3] *Ibid.*, pp.10-11.

(f) Unlike the public corporation, it is created by an executive decision of the government without Parliament's specific approval having been obtained, and its Articles of Association, though conforming to an Act, are drawn up and are revisable by the government;

(g) Its funds are obtained from the government and, in some cases, from private shareholders, and from revenues derived from the sale of its goods and services;

(h) It is generally exempt from the personnel, budget, accounting and audit laws and procedures applicable to government departments; and

(i) Its employees, excluding those who are on deputation, are not civil servants.

The Industrial Policy Resolution of 1948 had declared that the "management of state enterprises will, as a rule, be through the medium of public corporations under the statutory control of the Central Government, which will assume such powers as may be necessary to ensure this." But most of the public sector undertakings have been organised as companies.

The company form of organisation for public enterprises had come in for much criticism in the beginning. Since the government, in most cases, was the only shareholder, it was said that the provisions of the Company Law did not have much relevance to a government company. Another objection was that the organisation of public enterprises as companies reduced their accountability and diluted audit control. But this criticism was largely met by writing special provisions into the Companies Act in 1956 with regard to the submission of Annual Reports and Accounts and audit by the Comptroller and Auditor-General.

The Study Team on Public Sector Undertakings points out that the principal defects generally attributed to a government company are that[4]:

(i) It evades the constitutional responsibilities which a state-owned enterprise should have to government and Parliament;

(ii) The law regulating limited companies become a mere fiction because all or most of the functions normally vested in the shareholders and in the management are reserved to government;

(iii) A meeting of shareholders in the case of a government company is meaningless, for the declaration of profits and the appointments to the Board are naturally reserved to the government; and

(iv) The extent of autonomy that it provides can be materially affected or altered by the executive agencies of the government.

Mainly relying on the above considerations, most of which had emerged from a U.N. seminar held at Rangoon in 1954 (and later endorsed by another

---

[4] *Ibid.*, p.13.

U.N. seminar held at New Delhi in December, 1959), the Estimates Committee recommended[5] that all wholly state-owned public undertakings should generally be in the form of statutory corporations, and the company form should be an exception to be resorted to only —

(i) When the government may have to take over an existing enterprise in an emergency;

(ii) Where the state wishes to launch an enterprise in association with private capital; or

(iii) Where the government wishes to start an enterprise with a view eventually to transferring it to private management.

The government, however, did not accept this recommendation on the ground that the "company form was advantageous in that it allowed the flexibility and autonomy necessary for the successful operation of commercial enterprises and also provided for parliamentary control over the companies under the special provisions of the Companies Act."[6]

The decision taken by the government in 1961 on the recommendations of the Krishna Menon Committee on the form of organisation reads as follows: "Government consider that the form of management of the undertakings should be determined by the requirements of each case. Accordingly, from the point of view of flexibility of operations, the company form of management would be preferable, In some instances, it would be necessary to form statutory corporations, while in a few others, for various reasons, it would be desirable to run the undertakings as departmental organisations"[7].

From the characteristics of the government company mentioned above, it is clear that when the whole capital stock is not owned by the government, it is still generally regarded as a government company provided that the government owns not less than 51 per cent of the capital stock. Such companies are also described as "mixed" or "joint" companies. In such concerns, the government usually enjoys a substantial control of the management. Examples of such companies include Ashok Hotel and Hindustan Shipyard Ltd.

However, there are also examples of the management of the government companies being entrusted to private hands. Hindustan Machine Tools Ltd., Hindustan Shipyard Ltd., Hindustan Housing Factory Ltd., and Indian Telephone Industries Ltd., were, in the beginning, given out to foreign private firms for management.

---

[5] *Ibid.*, p.14.

[6] *Ibid.*

[7] *Ibid.*

Public Corporation

The important features of the public corporation (also known as statutory corporation) as mentioned by the Study Team on Public Sector Undertakings are given below[8]:

(a) It is owned by the State;

(b) It is created by a special law defining its objectives, powers and privileges and prescribing the form of management and its relationship with government departments;

(c) It is a body corporate and can sue and be sued, enter into contracts and acquire property in its own name;

(d) Except for appropriations to provide capital or to cover losses, it is usually independently financed; it obtains funds by borrowing either from the government or, in some cases, from the public and through revenues derived from the sale of goods and services, and has the authority to use and re-use its revenue;

(e) It is ordinarily not subject to the budget, accounting and audit laws and procedures applicable to government departments; and

(f) Excluding the officers taken from government departments on deputation, the employees of public corporations are not civil servants, and are not governed by government regulations in respect of conditions of service.

As the Study Team has pointed out, in most democratic countries, the public corporation has been the common form of organisation for public enterprises. "In the United Kingdom, the USA and Canada, the form of public corporation has been adopted. In Italy, the company form has been retained for concerns brought within the public sector; but it is confined to the sub-holding companies and operating units. The two top management institutions that control all the operating units and sub-holding companies are the ENI[9] and IRI[10] and they are statutory corporations. Thus, it is only in India that the government seems to have adopted the method of running companies by directly holding shares in them. In Italy, the state holdings are administered by public corporations which, in turn, hold shares in a number of companies. In India, the government companies have been subjected to both. While it is sometimes claimed that the advantages of the two systems, state managements and private enterprises, have been combined in government companies in India, many witnesses who appeared before us held the view that government companies had merely succeeded in accumulating the disadvantages of both."[11]

---

[8] *Ibid.*, p.11.

[9] *Ente National Idocarburi* (the Great Petroleum Complex).

[10] *Instituto per la Ricostruzione Industriale* (Institute for Reconstruction of Industry).

[11] A.R.C. *op. cit.*, p.15.

Preferring the public corporation to the company, the Team has pointed out that though "from the government pronouncements on the subject it appears that the company form is conducive to greater autonomy, the reports of the Parliamentary Committees indicate the very opposite."[12] In support it has also quoted the following comments made by the Estimates Committee: "The Committee has noticed that in the relations between these undertakings and the Ministry, the former are treated in the same manner as departments and offices of government, controlled and supervised by the secretariat. The state undertakings have thus become adjuncts to Ministries and are treated more or less on the same lines as any subordinate organisation of office".[13] The Team, therefore, felt that "the setting up of the public corporation will ensure a measure of real autonomy for the public enterprise."[14]

Holding Company

One of the important recommendations of the Study Team has been that integral public authorities should be created for particular sectors of industry and entrusted with the task of the general development of the respective sectors, including the running of undertakings in those sectors and the setting up of new projects. The Team recommended that, to promote this integration, it was necessary to amalgamate public undertakings in such a manner that one integral corporation functioned in each major area of public enterprise, operating the existing units and setting up new projects in the field of the industry entrusted to the corporation.

According to the Study Team, the setting up of the integral public corporation in the industrial and manufacturing field would result in the following advantages[15]:

(i) It will end the fragmentation of the industrial effort in the public sector and promote the integration of the efforts to develop each industry in the public sector;

(ii) It will reduce the span of government control, for many of the functions that are co-ordinative *per se* will be taken care of at the level of the integral corporation;

(iii) It will make government control more effective by confining it to a higher level and concentrating it on the few vital and strategic points that the government should control to discharge its responsibility for the formulation of policy and for ensuring that that policy is implemented by the management;

---

[12] *Ibid.*, p.18.

[13] *Ibid.*

[14] *Ibid.* p.19.

[15] *Ibid.*, pp.36-37.

(iv) It will secure for the management at the operating level greater detachment from direct bureaucratic control and political influence, both of which are inimical to initiative experimentation and vigorous management;

(v) It will enable public enterprises to establish otherwise expensive staff organisation in fields like designing and consultancy, cost and management, accounting, industrial engineering, and research;

(vi) It will lead to better personnel management in public enterprises, and greater uniformity in the terms and conditions of service of the employees;

(vii) It will enable the corporation to avail of the economies of large-scale operations and to establish common service facilities like training for the particular requirement of the industry and [illegible] chase and sales organisations with effectiveness and economy;

(viii) It will provide much wider prospects to the managerial and technical personnel of public enterprises, increasing the capacity of these enterprises to attract and retain suitable personnel; and

(ix) It will result in a more rational deployment and utilisation of designing and construction engineering personnel and expensive construction equipment.

SUITABLE FORM OF ORGANISATION

While each type of organisation has its own advantages and disadvantages, for a particular category of undertakings one form may be more suited than the others. The recommendations of the Study Team on Public Sector Undertakings in this respect are as follows[16]:

(i) Industrial and Manufacturing Undertakings: All public undertakings in the industrial and manufacturing field should be entrusted to public corporations, each governing a number of operating units in the same area of industry. It would be advantageous to retain the company form for units in which there is an element of private participation but in such cases, the state-owned shares held in the company should be owned not by the government directly but in the name of the public corporation.

However, the departmental form is generally regarded as the one suitable for undertakings that provide the services that affect the totality of the community or the security of the country.

(ii) Public Utilities and Services: It has been generally recognised that public utilities and services require greater statutory authority for their

---

[16] *Ibid.*

operations. Their operations also serve the community in general or a primary need of industry. The public corporation form is, therefore, more suitable for undertakings falling in the category of public utilities and services. The statutes of existing corporations in this category should be revised with a view to ensuring that they are in accord with the needs of autonomy and flexibility.

(iii) Promotional and Developmental Undertakings: The company form is not suitable for promotional and developmental undertakings. The very nature of these undertakings signifies that the accent is on non-commercial objectives, although the operations are sought to be carried on commercial lines and not on departmental lines. The government may re-examine the desirability of continuing these undertakings as government companies.

(iv) Commercial and Trading Concerns: A common objective of these undertakings is to act as instruments for the social regulation of trade and business in the field of their operation. Since these undertakings operate in competition with their counterparts in the private sector, there is perhaps some justification for retaining the company form of organisation for these undertakings.

PRICING POLICY IN PUBLIC ENTERPRISES

The public sector pricing policy is an issue that has been widely debated. Should the public sector undertakings earn profits? If they should earn profits, what should be the level of the profits? In areas where there are good prospects for making profits, should they exploit the market to the maximum or should there be a limit to profit rates? Should all the undertakings be run on commercial lines, or is it sufficient if the public sector as a whole makes profit?

If the public sector undertakings are not required to make a profit, what should be the pricing policy? Should it be marginal cost pricing, average cost pricing, or no-profit, no-loss pricing? What should be the factors that should determine the choice of any of the above policies?

These are the basic issues in public sector pricing. An understanding of the important theories of public sector pricing would make some of these issues more clear.

THEORIES OF PRICING

Marginal Cost Pricing

Marginal cost pricing refers to the method of setting prices in which price is made equal to the marginal cost of production. The marginal cost pricing implies that the price is set at the point at which the demand curve cuts the marginal cost curve.

The marginal cost pricing theory was first advocated by Professor Harold Hotelling in his article, "The General Welfare in Relation to Problems of Taxation and of Railway and Utility Rates", published in *Econometrica* in 1938. In this article, he argued that, by adopting the marginal cost pricing, even if the public utilities ran at a loss which had to be financed by lumpsum payments by the state, total economic welfare would be increased by such a pricing policy.

When production is subject to the law of decreasing costs (or increasing returns), the marginal cost price is lower than other prices (average cost price, no-profit, no-loss price, etc.). This lower price enables the poor sections of society to increase their consumption of public utilities. That is why Professor Hotelling argued that marginal cost pricing would improve economic welfare.

When production is subject to the law of decreasing costs, if marginal cost pricing is adopted, the total revenue will obviously be less than the total cost. It has been argued that this deficit in revenue should be made good by taxing the rich. When this is done, a part of the cost of the public utilities consumed by the poor is paid by the rich. Thus, marginal cost pricing would achieve an income re-distribution in favour of the poor and thereby an enhancement in total economic welfare.

But it should be pointed out here that it is not always possible to cover the revenue gap by progressive taxation. In India and in many developing countries, there is a limit to the amount that can be raised by means of direct taxes. The situation may necessitate higher commodity taxation, which may turn out to be regressive and/or deficit financing. If commodity taxation and deficit financing cause a rise in prices, it is likely to make the plight of the poorest sections more miserable, for the poorest strata usually do not have the economic capacity to consume even the subsidised public utilities. The marginal cost pricing, therefore, sometimes reduces the total economic welfare even under conditions of decreasing costs.

When production is subject to the law of increasing costs (decreasing returns), the marginal cost price represents at higher price than the average cost price or no-profit, no-loss price. Hence, marginal cost pricing under conditions of increasing costs will reduce the total economic welfare, for this higher price will reduce the poor people's consumption of public utilities.

If marginal cost pricing is adopted when production is subject to the law of increasing costs, the enterprise can generate some surplus.

There are some practical difficulties in marginal cost pricing. "Where there are multiple products or services, the determination of detailed costs of each item may be a very costly and complicated affair. There may, as a result, be large economies of administration if services involving unequal costs are charged at a uniform rate. This is the reason why the post office charges the same price for carrying letters from one street to another or from one corner of the country to another.

"The marginal cost cannot be accurately assessed because the factors are indivisible and the various charges on new factor intakes are not the charges on factor use needed for additional increments of output. Marginal costs would be high at points where capacity gets exhausted and for additional production new capacities have to be created. In such cases, the costs incurred at such points are abnormally high and thus the marginal cost cannot be a basis for price fixation.

"If the price is to equal marginal cost, fluctuations in demand and supply would lead to frequent fluctuations in prices, which is not very desirable".[17]

Average Cost Pricing

Average cost pricing refers to the method of setting prices in which price is equal to the average cost of production. Under average cost pricing, the total revenue equals total cost. Average cost pricing, thus, ensures the absorption of the full cost of production into the price.

When calculating the total cost, it is usual to include normal profit in it. Hence the average cost includes also the normal profit. The average cost price is, therefore, a little higher than the no-profit, no-loss price.

It has been argued that, in the case of the railways, posts and telegraphs, multi-purpose projects, etc., the average cost can be more easily calculated than the marginal cost.

Thiemeyer considers the average cost pricing to be fair and just because of the following reasons[18]:

(i) Public undertakings are expected primarily to meet needs, that is, to provide an optimum volume of supplies cheaply without seeking any profit.

(ii) Every purchaser pays the entire cost of the unit or units consumed by him instead of paying only the additional cost of producing these units.

(iii) Since nobody is required to pay more for the goods he purchases than the amount it actually costs to produce those goods, there is no exploitation.

(iv) The average cost price is a reliable criterion for investment in many cases.

(v) The average cost principle ensures that the entire expenditure of the undertaking is covered and thereby secures the viability and the autonomy of the undertaking.

Under conditions of decreasing costs, the average cost price is higher than the marginal cost price. Hence, the demand for goods or services will be lower if the average cost is the criterion for fixing the price. It will, it has been argued, adversely affect the interests of the consumers.

---

[17] K. R. Gupta (Ed.), *Pricing in Public Enterprises* (New Delhi: Atalantic Publishers and Distributors, 1978), p.9.

[18] *Ibid*, p.16.

When production is subject to the law of increasing costs, the average cost is lower than the marginal cost, and hence the average cost pricing will benefit the poor.

The INRICE Theory Committee points out that "the recommendation...that price should be fixed in terms of average unit costs is in practice inapplicable. To take one example, in the transport sector" ... no satisfactory method of allocating costs according to their origin has yet been found. The problem is at present insoluble on account of practical considerations; moreover, the task of correctly allocating cost elements is fraught with theoretical difficulties of principle, which cannot be overcome by any degree of improvement of the accounting systems of individual economic units and the economy as a whole".[19]

No-Profit, No-Loss Pricing

As the name indicates, the no-profit, no-loss theory holds that the price should be fixed in such a way that there will be neither any profit nor any loss. In other words, the price should just cover all the costs of production.

The average cost price usually includes the normal profit. The no-profit, no-loss price, however, does not provide for normal profit.

Unlike the marginal cost price, the no-profit, no-loss price does not require any subsidy for in this case there is no deficit in the revenue because of the equality between the total revenue and total cost. In other words, there is no need for any "cross subsidisation".

When the price is fixed on the no-profit, no loss basis, the non-consumers of the commodity or service are not compelled, directly or indirectly, to bear a burden for the benefit of the consumers. At the same time, the consumers are given a fair deal, for they bear nothing more than the actual cost of their consumption.

Like the average cost price, the no-profit, no-loss price relieves the state of the burden of mopping up resources to make good the deficit incurred when marginal cost pricing is adopted — when the production is subject to the law of decreasing costs.

Professor Arthur Lewis argues that if the corporation makes a profit or loss, it should be required to adjust its prices so as to eliminate the profit or loss. He advocates this principle on the ground that it will prevent over or under-expansion of the industries concerned and will avoid inflationary or deflationary tendencies.

---

[19] *Ibid.*, pp.16-17.

Profit-Making Pricing

The theory of making profits purports that the prices should be high enough to provide some surplus after absorbing all the costs.

That the public sector enterprises should generate a surplus with which to finance future development plans has been widely accepted today.

Many developing countries have assigned a very important role to the public sector in national development plans. Since the taxable capacity is low and the scope of domestic resource mobilisation through other means is limited, the public sector, which has absorbed large chunks of investment, should be expected to make a significant contribution to the pool of investible funds.

Many economists and planners argue that as the public sector acquires a more prominent position, the role of taxation, deficit, financing, etc., in resource mobilisation should decline and the surplus provided by the public sector should increase. In an economy where the public sector occupies an important position in production and supply, there is good scope for mopping up resources by an appropriate public sector pricing policy.

As a matter of fact, in communist countries, most of the financial requirements of the government are met by the surpluses generated by public enterprises through a pricing strategy that serves this purpose.

It may be pointed out here that had the public sector in India generated a reasonable return on the enormous capital investment in them, the pace of economic progress would have been stepped up. In the absence of a satisfactory level of surpluses from the public sector, we are compelled to put up with more taxes, more deficit financing (which are inflationary in nature) and the slow pace of economic growth.

Indian Public Sector and Profit Objective

It is quite clear from the plan documents and the pronouncements of people like the Prime Minister that the public sector in India is expected to augment resource availability for national development by making profits.

According to the late Prime Minister, Mrs. Gandhi: "We advocate the public sector for three reasons: to gain control of the commanding heights of the economy; to promote critical development in terms of social gain or strategic value rather than primarily on consideration of profit; and to provide commercial surpluses with which to finance further economic development".[20] Thus, making profits to make resources available for investment is certainly an important objective of the Inian public sector.

---

[20] Cited in Government of India, *Public Sector Forges Ahead* (New Delhi: Publications Division, 1975), p 5.

The late Mr. T. A. Pai, when he was Union Minister for Industries, argued that a 12 per cent return on investment in the public sector should be regarded as reasonable.

Mr. V. K. R. V. Rao, a well-known economist, former Union Minister and former member of the Planning Commission, pleaded that the pricing policy of the public enterprises "should be such as to promote the growth of national income and the rate of this growth ...Public enterprises must make profits, and the larger the share of public enterprises in all enterprises, the greater is the need for their making profits. Profits constitute the surplus available for savings and investments on the one hand and contribution to national social welfare programmes on the other; and if public enterprises do not make profits, the national surplus available for stepping up the rate of investment and the increase of social welfare will suffer a corresponding reduction... Hence the need for giving up the irrational belief that public enterprise should, by definition, be run on a no-profit basis".[21]

As the Taxation Enquiry Commission has remarked: "...In certain cases, where the state has made a substantial investment, a policy of regulating prices so as to secure an adequate return on the capital invested is not only unobjectionable but may, indeed, be desirable. This is particularly so in the conditions of economically underdeveloped countries, where public enterprise itself, fostered at state expense, may in turn play a role in financing the country's development".[22] The Industrial Policy Resolution, 1956, states: "It is to be expected that public enterprises will augment the revenues of the state and provide resources for further development in fresh fields".

Our Five Year Plan documents have pointed out that the public sector should make a significant contribution to the pool of investible funds by generating commercial surpluses. The Third Plan observed: "Substantial investments have been made in the public sector over the last ten years, and every effort must be made to ensure that they yield an adequate surplus on the basis of which to plan a further advance. Development has, in due course, to become self-financing; the surpluses from past investments constitute the source for further development. It is important that in choosing their projects for implementation, the Central as well as State Governments keep constantly in mind the needs to get results from these investments as quickly as possible".[23]

The Fourth Plan mentioned that the government had accepted in principle the recommendation of the Committee on the Working of State Electricity Boards (Venkataraman Committee) that the rate of return on capital employed should be raised to 11 per cent per annum on the basis of a phased programme. As regards the irrigation charges, the Plan document cited the important recommendations of the Committee to Suggest Ways and Means of Improving Financial Returns from Irrigation Projects (Nijalingappa Committee), and underscored the need to mop up resources from the beneficiaries of the irrigation projects. The Plan document further suggested: "Efforts should be directed to raise the rate of returns on capital employed to 15 per cent by industrial and commercial undertakings other than public utilities".[24]

---

[21] Cited in K. R. Gupta, *op. cit.*, p.19.

[22] *Ibid.*

[23] Government of India, *Third Five Year Plan*, p.116.

The Fifth Plan also emphasised the need to ensure a reasonable return on public sector investments by improving their operational efficiency. The Draft Five Year Plan, 1978-83, suggested that the Central Government's non-departmental undertakings should aim at earning a return on investment of 10 per cent per annum.

The Sixth Plan suggests: "Almost all the Central and State enterprises would need to adopt appropriate pricing policies in order to achieve an adequate rate of return on capital employed. Although a substantial revision of tariffs, freight rates and prices had been undertaken in the past, the additional receipts have largely been absorbed by escalation of working expenses due to the revision of emoluments to their employees, rise in input costs, etc. It is, therefore, essential to ensure that the additional resources generated by these enterprises during the Sixth Plan period by way of revision of prices, tariffs, etc., are not eroded by cost increases and that efforts are made simultaneously to secure the maximum feasible improvement in the functioning and efficiency of these enterprises".[25]

The preceding paragraphs make it quite clear that the public sector in India is required to make a profit to step up the level of investment and accelerate the pace of economic progress. This, however, does not mean that each and every enterprise is expected to make a contribution by way of profit. There are some public enterprises which are not specifically required to operate on commercial basis, while most of the enterprises are expected to generate commercial surpluses. For instance, the agreements between the Government of India the WHO and the UNICEF require the Hindustan Insecticides and the Hindustan Antibiotics to operate on no-profit, no-loss basis. The ECGC has also been intended to be run on the same principle. Most of public enterprises, including the Road Transport Corporations, Electricity Boards and State Financial Corporations, have been expected to conduct their business on commercial lines.

In short, public enterprises as a whole should generate commercial surpluses to augment the pool of investible funds. People of different capacities have suggested that the pricing policies of public enterprises should be suitably revised to enable them to break even and make profits. But, while revising the prices with a view to enabling them to make profits, it should be ensured that the consumers are not made to bear the burden of the inefficient and improper management of these enterprises. The Third Plan had pointed out : "Even a comparatively small delay in completing a project and putting it into productive use can make a significant difference to the resources available for investment. The point is that, as an economy develops, even marginal improvements in planning and execution over a number of points can yield a large return in the aggregate".[26] Two decades after this observation was made, the Planning Commission still regreted : "The operational efficiency of these enterprises has to be substantially improved in order to obtain a fair rate of return on public investment".[27]

---

[24] Government of India, *Fourth Five Year Plan*, p.84.

[25] Government of India, *Sixth Five-Year Plan* (1980-85), p.63.

Influences and Guidelines on Pricing Policy

A uniform price for all the public enterprises is ruled out because the nature of goods or services they produce or provide, the production function and the market situations are not uniform. On the basis of the nature of their business, public enterprises in India may be classified into the following categories:

(i) Enterprises engaged in the production or provision of public utilities and services.

(ii) Enterprises engaged in the production of consumer goods.

(iii) Enterprises engaged in the production of basic and capital goods.

(iv) Enterprises engaged in the trading business.

(v) Financial enterprises.

The determinants of the pricing policies of these different classes of enterprises obviously differ.

The Administrative Reforms Commission has recommended that the following principles should be kept in view in formulating the pricing policies of public enterprises[28]:

(i) Public enterprises in the industrial and manufacturing field should aim at earning surpluses to make a substantial contribution to capital development out of their earnings, besides making a contribution to the national exchequer.

(ii) Public enterprises should in any event pay their way and should not run into losses except in pursuance of the express directives issued by the government in public interest.

---

[26] Government of India, *Third Five Year Plan*, p.116.

[27] Government of India, *Sixth Five Year Plan*, p.62.

[28] ARC, *op. cit.*

(iii) In the case of public utilities and services, greater stress should be laid on output than on return on investment, the former being extended up to a level at which marginal costs is equal to price.

(iv) While determining the price structure commensurate with the surpluses expected from them, public enterprises should keep the level of output as near the rated capacity as possible, subject, of course, to the volume of demand for the product.

The Bureau of Public Enterprises is intimately concerned with the problems of pricing. Its main activity is directed towards dealing with specific cases as they arise, rather than with general industry studies. It also issues guidelines to public enterprises on pricing policies. The BPE issued the following guidelines[29]:

(i) For enterprises which produce goods and services in competition with other domestic producers, the normal market forces of supply and demand will operate, and their products will be governed by the prevailing market prices.

(ii) For enterprises which operate under monopolistic or semi-monopolistic conditions, the landed cost of comparable imported goods would be the ceiling. Within this ceiling it would be open to the enterprises to have price negotiations and fix prices at suitable levels. If the landed cost is found or believed to be artificially low, or in other exceptional circumstances it is considered necessary to have higher prices, then the matter should be referred to the Administrative Ministry, the BPE, and the Ministry of Finance.

(iii) Ministries and government departments and public sector enterprises should invariably purchase their requirements from public sector undertakings to the maximum possible extent. Quality requirements and reasonable delivery schedules should of course be enforced, subject to negotiation for agreement on price. Price preference not exceeding 10 per cent will be admissible to public sector undertakings. Where a public sector undertaking requires price preference of more than 10 per cent, the Purchasing Ministry, department or public enterprises should endeavour to reach an agreement by negotiation; where such an agreement is not possible within a reasonable time, the cases have to be submitted to the Cabinet Committee for Economic Coordination. Price preference even up to 10 per cent cannot be permanent or taken for granted. Every effort should be made to bring down costs and achieve competitiveness.

---

[29] Cited in Khera, S. S., *Government in Business* (New Delhi : National Publishing House, 1977), p.344.

The pricing policies and practices are profoundly influenced by the competitive situation, the nature of the industry, the supply-purchase relationship with other public enterprises and government departments, etc. "Even a cursory examination of the market conditions under which the public enterprises produce and sell their goods and services would reveal several types of situations. Some enterprises come under a system of price control and regulation, while others operate in the open market; still others operate in international markets. For some enterprises, the Central Government is the sole buyer, others are linked to State Governments and other public enterprises which are their main customers. One can easily see that the managements of public enterprises are not entirely free to set their prices without some constraints".[30]

On the basis of the pricing criteria and practices of different kinds of enterprises, the Bureau of Public Enterprises has made the following broad classifications:[31]

(i) Enterprises under a system of price control by the government.
(ii) Enterprises which sell their products entirely to the government.
(iii) Enterprises which sell their products mainly to State government enterprises or to other public sector enterprises.
(iv) Enterprises selling their products in the international market.
(v) Enterprises operating in the open market.
(vi) Steel.
(vii) Price fixation by arbitration and award by the government.

Pricing Practices

Some examples of the pricing policies and methods followed by public enterprises are given below:

(i) ***Administered Prices.*** Prices of certain commodities like steel, coal, fertilizers, etc., are fixed by the government.

(ii) ***No-Profit, No-Loss Prices.*** The Damodar Valley Corporation (DVC) fixes the price of irrigation water on the no-profit, no-loss basis. As mentioned earlier, other enterprises which practise this policy include the Hindustan Antibiotics, Hindustan Insecticides and the Export Credit Guarantee Corporation (ECGC).

(iii) ***Cost-Plus Prices.*** Enterprises like the Indian Telephone Industries, Hindustan Aircraft, Bharat Electronics, etc., fix prices on a "cost-plus" basis.

---

[30] Government of India, *Public Sector Forges Ahead, op. cit.*, p.18.

[31] Cited in S. S. Khera, *Government in Business, op. cit.*, p.318.

(iv) ***Competitive Prices.*** Certain public sector undertakings like the Ashok Hotel fix the prices on the basis of the competitive situation.

(v) ***Following the Leader.*** Price decisions of a few public enterprises are based on the behaviour of the leader. For instance, the Kerala Soaps and Oils takes into account the prices of the brands of Hindustan Lever, Tata and Mysore Sandalwood while fixing prices for its different types of soap.

(vi) ***Parity Pricing.*** For the products of some of the enterprises which have a monopoly position in the domestic market, parity with the landed cost of the imported commodity is sought. This was, for instance, true of the Hindustan Shipyard which established the UK parity.

(vii) ***Subsidised Prices.*** Some enterprises which enjoy the benefit of a subsidy from the government sell their products below the cost of production. An example is the price of the contraceptive produced by the Hindustan Latex.

(viii) ***Trade Association Pricing.*** Air-India International, like other international airlines, adopts the fares and freights determined by the International Air Transport Association (IATA). Similarly, the Shipping Corporation of India fixes its prices on the basis of the recommendations of the Shipping Conference.

(ix) ***Discriminatory Pricing.*** Many public enterprises practise price discrimination. Almost all the public sector financial institutions do this. This is true of Electricity Boards and the Railways.

GOVERNMENT AND PARLIAMENTARY CONTROLS OVER PUBLIC ENTERPRISES

A certain amount of autonomy is a necessary condition for the efficient functioning of any enterprise; and the public enterprises are no exception to this. But public enterprises have been established with public funds to serve social purposes, and hence there should be public control over them to ensure that they discharge their duties promptly and efficiently and fulfil their objectives. Public control is exercised through the government and Parliament, the representatives of the people. Government and Parliament controls over public enterprises do not mean that the enterprises should not have any autonomy. They should necessarily have a certain amount of autonomy. It is the general policy, overall performance and decisions with long-term implications that are generally sought to be controlled by the government and Parliament. *Autonomy vs. Accountability* has been, however, one of the unsettled issues in public enterprises.

Pandit Nehru observed: **"I have no doubt that the normal governmental procedure applied to a public enterprise will lead to the failure of that public** enterprise. Therefore, we have to evolve a system for working public enterprises where, on the one hand, there are adequate checks and protections, and on the other, enough freedom for that enterprise to work quickly and without delay. Ultimately, it has to be judged by the results, though one cannot judge a government enterprise by financial results alone. In judging a big enterprise, one has to judge by final results. Of course, there are checks and audit and all that, but checks come afterwards. The chief man on the top must be able quickly to do what he wants to do".[32]

Government control over public enterprises is usually exercised by giving guidelines and directions for the functioning of the enterprise; appointing the top managerial and administrative personnel like the Chairman/Managing Director and members of the Boards of Directors; requiring government approval for long-term plans, large investments and major policy changes; calling for periodic reports and returns; accounts and audit control, etc. Parliamentary control is exercised by discussions in Parliament and parliamentary committees.

In the early days, the government tended to exercise too much control, and only limited powers were delegated to enterprises. However, on the recommendations of the Administrative Reforms Commission, it was decided to reserve only the following well-defined powers for the government:

(i) Appointments of chief executives and full-time and part-time members of the Boards of Directors.

(ii) Sanctioning of capital programmes involving expenditure of a certain magnitude.

(iii) Approval of five-year annual plans of development and capital budgets.

(iv) Authorisation of capital to be raised and the conditions thereof.

(v) Approval of the revenue budget where a deficit was required to be met by the government.

(vi) Calling for returns, accounts and other information on the activities of the enterprise.

(vii) Giving directions to the enterprise on matters involving national security or substantial public interest.

Except the chief executives and members of the Boards of Directors who are appointed by the government, appointments to all posts are made by the enterprises. Government nominates on the Board of Directors usually two government officials, one representing the administrative ministry and the other representing the Ministry of Finance. These part-time directors, by providing a two-way channel, are expected to facilitate liaison between the government and the public enterprise.

---

[32] "Nehru on Public Sector", *Yojana*, January 26, 1981, p.16.

The limit of the expenditure the management of the enterprise can incur by itself without requiring the approval of the government usually varies with the size of the enterprise. All the investments beyond the specified limit require the approval of the Public Investment Board, which is headed by the Secretary (Expenditure) in the Ministry of Finance. To evaluate the investment proposal, the Public Investment Board can avail of the professional expertise and advice of the Project Appraisal Division of the Planning Commission and the Bureau of Public Enterprises. The important criteria adopted by the Planning Commission are the relevance of the proposed investment to be overall National Plan, the availability of resources and the social cost-benefit analysis. The Bureau of Public Enterprises, on the other hand, evaluates the proposal from the point of view of its financial, technical and economic viability. Thus, the Planning Commission's appraisal pertains to the macro aspects and that of the BPE to the micro aspects of the project.

In India, public enterprises are placed under the control of different functional ministries. The ministries have the responsibility to ensure that enterprises under their administrative control function effectively and in a manner conducive to the achievement of the objectives underlying their formation. For this purpose, they lay down, in consultation with the management of the enterprises, their annual targets of production/turnover, and carry out a periodical appraisal of their performance at review meetings.

Baveja[33] points out that although the government is empowered to issue directives to enterprises to conform to its policies, this is not the normal practice followed except in certain very special cases. The compliance by the enterprises with the policies of the government is achieved by the issue of instructions which are in the nature of guidelines or model rules, and it is left to the judgement of individual enterprises to adopt the suggested course of action with or without adjustments. The guidelines issued by the government relate to various matters, such as personnel and wage policies, general conditions of the service of employees, model conduct rules, economy in the field of construction, and provision of amenities in townships, etc.

Parliamentary Control and Public Accountability

Parliamentary control is a very important aspect of the performance appraisal of public enterprises in India. One of the former Speakers of the Lower House of Parliament, Shri G. V. Mavalankar, once observed: "Merely because the system makes them autonomous, it does not follow that the system can take away the jurisdiction of Parliament for having a full probe into the administration of the autonomous body".[34]

---

[33] G. C. Baveja, "Relationship of Indian Public Enterprises with Government and Parliament," in *Issues in Public Enterprises Development* (Report of a Seminar organised by the Commonwealth Secretariat and the Government of India, New Delhi, 27th February, 3 March, 1978).

[34] *Ibid.*

There are three important methods by which Parliamentary control over public enterprises is exercised in India:

(i) Holding Debates in Parliament: A debate on the performance or some other issue pertaining to public enterprises may be initiated during the budget debates, or on a discussion of the President's address, or by moving resolutions on any topic, by raising an half-hour discussion on a public undertaking, by moving a motion for adjournment on a matter of public importance, by short discussions on matters of urgent public importance, or "calling the attention" of the House to some urgent matter during discussions on reports of enquiries, or while introducing or amending the statutes of a corporation, or on a presentation of the annual reports.

(ii) By Interpellation: This means interrupting the proceedings in Parliament and demanding a statement or explanation from the Minister. There is a practice of setting apart one opening hour of Parliament's meeting time for questions and answers. Members of the House give due notice of their questions to the Ministers and the Ministers concerned give the House the answers which they may prepare with the help of civil servants.

(iii) By Parliamentary Committees: Special Committees of Parliament, consisting of the members belonging to various parties, examine the various aspects of the functioning of public enterprises.

The CPU

In the earlier years, the Public Accounts Committee and the Estimates Committee of Parliament examined the working of public enterprises. But as these committees were overburdened with work, and also because the criteria for the appraisal of performance of public enterprises had to be different from those applied to the work of the government departments with which these committees were concerned, the Committee on Public Undertakings was set up in 1964. The members of the CPU are drawn from both the Houses of Parliament. The terms of reference of the Committee are as follows:

(i) To examine the reports and accounts of public enterprises;

(ii) To examine the reports, if any, of the Comptroller and Auditor-General of India on public enterprises;

(iii) To examine, in the context of the autonomy and efficiency of public enterprises, if their affairs are managed in accordance with sound business principles and prudent commercial practices, and to exercise such other functions in relation to public enterprises as may be allotted to it by the Speaker from time to time.

At the beginning of each financial year, the Committee on Public Undertakings selects for examination-in-depth some 8 to 10 enterprises. These studies cover in great depth every aspect of the working of the enterprises. The secretaries of the administrative ministries, the chief executives of public enterprises and other senior officials are required to appear before the Committee to give oral evidence. The reports of the Committee are thereafter presented to Parliament. An examination of the working of an enterprise by the Parliamentary Committee is essentially in the nature of an evaluation of the performance of that enterprise, and it enables the Committee to make recommendations on how the working of that enterprise may be improved to enable it to discharge more effectively the role assigned to it.[35]

Apart from examining the working of individual enterprises, the CPU undertakes horizontal studies affecting public enterprises as a whole. Some of the horizontal studies of the Parliamentary Committee include foreign collaboration in the public enterprises, financial management, public relations and publicity, personnel policies and the role and achievements of public undertakings.[36]

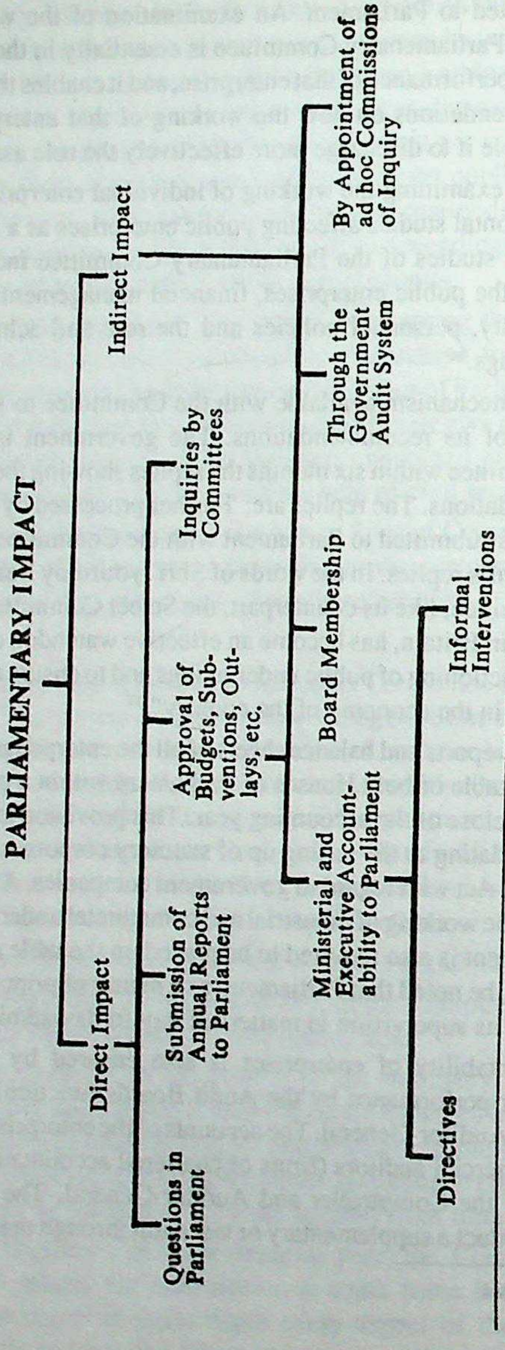
There is a mechanism available with the Committee to follow up the implementation of its recommendations. The government is required to furnish the Committee within six months the replies showing the action taken on its recommendations. The replies are: Further processed by the Committee and a report is submitted to Parliament with the Committee's comments on the government's replies. In the words of Shri Jyotirmoy Basu : "Over the years, this Committee, like its counterpart, the Select Committee on Nationalised Industries in Britain, has become an effective watchdog of Parliament to oversee the functioning of public undertakings and to ensure that they play a stabilising role in the economy of the country".[37]

The annual reports and balance sheets of all the enterprises are required to be laid on the table of both Houses of Parliament within a period of nine months from the close of the accounting year. This provision is contained in the enactments relating to the setting up of statutory corporations as well as in the Companies Act with regard to government companies. A consolidated annual report of the working of industrial and commercial undertakings of the Central Government is also required to be placed on the table of the House. It must, however, be noted that Parliament, as a matter of principle, does not generally extend its supervision to matters of day-to-day administration.[38]

The accountability of enterprises is also ensured by a systematic appraisal of their performance by the Audit Boards functioning under the Comptroller and Auditor-General. The accounts of the enterprises are subject to audit by commercial auditors (firms of chartered accountants) appointed on the advice of the Comptroller and Auditor-General. The latter is also authorised to conduct a supplementary or test audit through the Audit Board.

---

35. G. C. Baveja, *Ibid.*
36. *Ibid.*
37. *Ibid.*
38. *Ibid.*


PARLIAMENTARY IMPACT
Direct Impact
Indirect Impact
Questions in Parliament
Submission of Annual Reports to Parliament
Approval of Budgets, Subventions, Outlays, etc.
Inquiries by Committees
Ministerial and Executive Accountability to Parliament
Board Membership
Through the Government Audit System
By Appointment of ad hoc Commissions of Inquiry
Directives
Informal Interventions

This chart has been adapted from the United Nations' publication, *Organisation, Management and Supervision of Public Enterprises in Developing Countries* (a study prepared by V. V. Ramanadhan), p. 100.

These Audit Reports, together with the comments of the Comptroller and Auditor-General, are presented to Parliament and are available for the use of the Committee on Public Undertakings in its examination of the performance of public enterprises.[39]

BUREAU OF PUBLIC ENTERPRISES

The need to provide a central focal point of reference and consultation to deal with matters of common interest to public enterprises, like organisational patterns, methods of management, personnel policies, collaboration agreements, project scrutiny and clearance, project and corporate planning, etc., was increasingly felt; and on the recommendations of a Parliamentary Committee, the Bureau of Public Enterprises was set up in the Ministry of Finance to serve this purpose. The services of the Bureau are available to all the administrative ministries and public enterprises in identifying, analysing and finding solutions to their major problems.

In September 1985, the government decided to bring the BPE under the Ministry of Industry.

Functions

The functions of the BPE are the following:

(a) to assist the Ministry of Finance and other ministries in scrutinising and evaluating feasibility studies and detailed project reports;

(b) to undertake studies so as to assist ministries in controlling expenditure on construction of factories and townships and other ancillary facilities so as to secure a measure of rationalisation and adherence to norms;

(c) to advise on the terms and conditions of service of employees with a view to ensuring desirable uniformities;

(d) to act as a 'Data Bank' and to serve as a clearing house of information in matters of common interest;

(e) to furnish periodical reports to Parliament and Government on the working of public undertakings;

(f) to co-ordinate the work relating to examination of public undertakings by Parliamentary Committees;

(g) to maintain liaison with other agencies in respect of management services like work study, operations research and reporting systems, etc.

(h) to assist the administrative ministries in making appointments to the boards of public undertakings through Public Enterprises Selection Board whose Secretariat is an independent division of the BPE;

---

[39] *Ibid.*

(i) to co-ordinate the arrangements for training the senior and top level managers of public enterprises and to advise and assist them in management development; and

(j) to advise and assist the concerned ministries and public enterprises on various other matters on which advice and assistance are sought.

Implicit in its functions is responsibility of the Bureau to explore all possible avenues of economy, both in capital and operating costs, in order to raise the productivity and profitability of public enterprises. Therefore, the Bureau takes the initiative for the promotion of sound management techniques by public enterprises. The major areas in which the Bureau's thrust has been directed are: corporate planning, management development and training, management information systems, modern management techniques, maintenance of equipment, pricing policy, evolution of financial policies in regard to depreciation, dividend, working capital, capital structure, etc.

The Bureau has scrutinised many feasibility reports and detailed project reports. The techno-economic scrutiny of these reports relates to a close examination of investment proposals from such angles as demand, rationalisation of capacity and product-mix, the build-up of production capacity, process feasibility and equipment, manpower build-up, project cost and planning, and control of project establishments. The primary objective of these scrutinies is to ensure the optimum utilisation of resources in setting up the project.

Since the construction of projects involves considerable outlay in resources as well as time, the Bureau keeps a constant watch on the progress of the projects under construction. Public enterprises have been advised through guidelines on the manner of systematic planning and scheduling of construction by the use of the network technique and monitoring services. Several measures have been taken to effect economy in the use of scarce material like steel and cement.

NATIONALISATION

One of the important contributory factors to the growth and expansion of the public sector has been the nationalisation of certain industries as a whole and certain undertakings in some of the other industries.

"Nationalisation in the establishment of the public ownership of the means of production by taking them over from private proprietors or foreign states, and subsequently transferring them to the control of the national government. Nationalisation is a complex process. Since it is initiated by the state, it always reflects changes in the alignment of political forces and interests, and is, therefore, primarily a political move. Since nationalisation brings about a change in the economic position of various groups, classes and forces and entails a redistribution of resources, it has far-reaching economic consequences, which is why, of course, it is undertaken. Naturally, nationalisation also affects social relations and brings about a change in the correlation of social forces. Finally, it affects political and economic relations with other states and groups".[40]

Since the post-war period, a number of important nationalisations have taken place in India. The earlier nationalisations were in the strategic and critical sectors; but later the scope of nationalisation was widened.

The Industrial Policy Resolution of 1948 clearly stated that, "in any emergency, the government would always have the power to take over any industry vital for national defence", and that the state will not "hesitate to intervene whenever the progress of an industry under private enterprise is unsatisfactory". The government has always stuck to this policy.

The important objectives of nationalisation are:

(i) To have effective control over the strategic and basic sectors of the economy;

(ii) To put an end to mismanagement by private capitalists;

(iii) To ensure better utilisation of the productive resources and to serve the genuine needs of the priority sectors and weaker sections;

(iv) To maintain employment and to safeguard the interests of the workers;

(v) To protect the interests of consumers;

(vi) To take the necessary action for the development of the concerned industry or business.

We may recall here some of the important nationalisations, that took place after independence.

The banking sector witnessed four important nationalisations, including the nationalisation of the Reserve Bank of India in 1949. The Imperial Bank of India was nationalised and the State Bank of India was established in 1955. In 1969, fourteen major commercial banks in the private sector were nationalised. With the nationalisation of another six banks in 1980, more than 90 per cent of the commercial banking business is now in the public sector.

The government has also established monopoly in the insurance business. In 1956, life insurance companies and in 1972 general insurance companies were nationalised.

The government acquired the Mazgaon Docks, Bombay, and the Garden Reach Workshop, Calcutta, in 1960, and the Hindustan Shipyard in 1961.

---

[40] V. Kolesov, *The Public Sector* (New Delhi: Sterling Publishers Pvt. Ltd., 1980), pp. 54-55.

The coking coal mines were taken over in 1972 and the non-coking mines in 1973. The next three years witnessed the nationalisation of foreign oil companies.

Apart from the nationalisation of certain industries, wholly or partially, individual undertakings in some other industries have also been nationalised to protect the interests of the workers and consumers to fulfil certain other objectives. The National Textile Corporation (NTC), set up in 1968, took over many sick mills. Under the Industries (Development and Regulation) Act, 1951, the government has taken over the management of a number of sick units. Thirteen sick units, earlier managed under the IDRA, were nationalised in 1980.

State governments, too, have been showing interest in the nationalisation of certain important sectors. Road transport has been a common area of nationalisation. Some States like Kerala have nationalised private forests and plantations owned by foreign companies.

A lot of criticisms have been directed against the performance of the nationalised sectors and undertakings. The nationalised business, by and large, has failed to rise up to expectations.

PRIVATE SECTOR

In a mixed economy, the private sector, too, has an important role to play. Indeed, it is because of the appreciation of the positive role the privaite sector can play, and certain limitations of the public sector, that many socialists advocate a mixed economic system. The Industrial Policy Resolution of 1956, which still remains the core of our industrial policy and which has assigned a dominant role to the public sector in a number of vital industries, has made it very clear that, "*As an agency for planned national development, in the context of the country's expanding economy, the private sector will have the opportunity to develop and expand*". It is thus clear that the adoption of the principle of the socialist pattern of society has not meant the end of the private sector. Instead the private sector has been assigned, and is expected to play, a very important role.

It must, however, be noted that the government's policy, as expressed in the Industrial Policy Resolution, 1956, is that "the adoption of the socialist pattern of society as the national objective, as well as the need for planned and rapid development, require that all industries of basic and strategic importance, or in the nature of public utility services, should be in the public sector. Other industries, which are essential and require investment on a scale which only the state, in the present circumstances, can provide, have also to be in the public sector". Accordingly, the future development of 17 industries of vital importance listed in *Schedule A* to the Industrial Policy Resolution has been exclusively reserved for the public sector, and in another 12 important industries, listed in *Schedule B*, the state will play the dominant role. The

Policy Resolution stated that it was expected that the development of the remaining industries "will be undertaken ordinarily through the initiative and enterprise of the private sector, though it will be open to the state to start any industry even in this category. It will be the policy of the state to encourage the development of these industries in the private sector, in accordance with the programmes formulated in successive Five Year Plans, by ensuring the development of transport, power and other services, and by appropriate fiscal and other measures. The state will continue to foster institutions to provide financial aid to these industries, and special assistance will be given to enterprises organised on co-operative lines for industrial and agricultural purposes". While shortcomings still exist, it must be said to the credit of the government that a remarkable progress has been achieved on these lines. It may also be pointed out here that a number of private sector enterprises that already existed in the industries included in the Schedule A have been allowed to develop further.

The Industrial Policy Resolution of 1956 has also made it clear that, *"Industrial undertakings in the private sector have necessarily to fit into the framework of the social and economic policy of the state and will be subject to control and regulation in terms of the Industries (Development and Regulation) Act and other relevant legislation. The Government of India, however, recognises that it would, in general, be desirable to allow such undertakings to develop with as much freedom as possible, consistent with the targets and objectives of the national plan. When there exist in the same industry both privately and publicly-owned units, it would continue to be the policy of the state to give fair and non-discriminatory treatment to both of them"*

The preceding paragraphs give us some idea of the government's policy towards the private sector and the industrial spheres open to that sector. Even in the areas where the private sector has been allowed, its operations and development have been regulated by the government in the public interest. The large industrial houses and foreign concerns, particularly, had been subject to a number of checks and controls. Their role had been confined to certain important areas like the heavy investment sector, the core sector, the export sector and backward areas development. The government's policy was to prefer small and new entrepreneurs to large industrial houses in the private sector, wherever possible.

The private sector is dominant in most of the consumer goods industries. It plays an important role in a number of capital goods industries, too. In a number of important industries, it functions side by side with the public sector.

The joint sector also reflects to some extent the importance of the role of the private sector.

With the new industrial policy announced on July 24, 1991, and modifications introduced thereafter, the role of the private sector has been tremendously increased.

JOINT SECTOR

The term *joint sector* refers to the enterprise owned and managed jointly by the private sector and the government/public sector undertakings. The Dutt Committee (Industrial Licensing Policy Inquiry Committee) has defined the concept of the joint sector in the following terms: "The joint sector would, in our view, include units in which both public and private investments have taken place and where the state takes an active part in direction and control".

Formation of Joint Sector Enterprises

Joint sector enterprises may be brought into being by any one of the following ways:

(i) The Central Government and private entrepreneurs may jointly set up new enterprises. Sometimes, the Central Government and one or more State Governments together may set up enterprises in partnership with the private sector. (It may be pointed out that the public may also hold shares in joint sector enterprises.)

(ii) State governments or their industrial development corporations may set up new companies jointly with private partners, involving equity participation by both the partners.

(iii) Public financial institutions may, through equity participation or conversion of loans or debentures into equity, transform enterprises promoted by private entrepreneurs into joint sector companies.

(iv) The existing private enterprises may be transformed into joint sector enterprises by the government or government companies acquiring a part of the equity or converting debt into equity or by contributing to an increase in the share capital.

(v) The existing public sector companies may be transformed into joint sector enterprises through the sale of some equity shares to private entrepreneurs or the general public.

Industrial investment corporations and industrial development corporations in a number of states have actively promoted joint sector enterprises. In a number of these cases, 26 per cent of the equity is held by the SIIC/SIDC, 25 per cent by private promoter(s) and 49 per cent of the shares are offered to the public.

In pre-independence days, the Princely States of Mysore and Hyderabad had established several industrial enterprises in which equity participation by the general public was permitted. In the years following Independence, a number of companies were floated by the government in collaboration with the private sector by sharing ownership, management and control with them. This form of industrial organisation was found appropriate for the import of foreign technology and capital, as in Cochin Refineries (1963), Madras Refineries (1965), and Madras Fertilisers (1966); for the utilisation of indigenous entrepreneurial and managerial resources, as in Air-India (1947); for the use of organisational capabilities of existing industrial houses, such as the Bird Heilgers group in Bolani Ores (1957); and the mobilisation of financial resources from the public, as in the Gujarat State Fertiliser Company (1965).[41]

Rationale of Joint Sector

The joint sector is conceived as a marriage between the managerial expertise of the private sector and the financial resources and social orientation of the public sector. It is viewed as an effective means of achieving a mixed economy. "In a sense, joint sector enterprises represent an application of the concept of mixed economy at the micro level".

The main objectives and advantages of the joint sector are:

(i) Curbing Concentration of Economic Power: The Dutt Committee advocated the joint sector, viewing it as an important means of curbing the increasing concentration of economic power. The Committee even regarded the joint sector as possibly more effective than licensing in achieving this objective.

***(ii) Social Control of Industry*:** Government participation in equity and management is expected to give a social orientation to the enterprise. The joint sector would ensure that the management of industry is conducted according to the overall policies laid down by the government, and that public interest and not merely private profit would guide the operations of the enterprises. "Used effectively and with care, the joint sector can be a more useful instrument than all rules and regulations and penal powers of the state in ensuring that development is according to plan. The concept of the joint sector has thus the potential, if properly used, to get the best advantages out of the mixed economy which has been accepted in our country as a matter of state policy".[42]

(iii) Acceleration of Economic Development: The joint sector, by mobilising and augmenting the productive resources, can accelerate the pace of economic development. It enables private entrepreneurs and the state agencies to promote or invest in a greater number of projects than would otherwise be possible. "The resources of the private sector in savings, investments and entrepreneurship can be harnessed in the joint sector with active state help to supplement the efforts made by the state in the public sector without the private profit motive being allowed to vitiate the effort.[43]

***(iv) Promotion of Mixed Economy*:** It is also expected that the joint sector will promote the mixed economy and help achieve development

---

41. Samuel Paul, S. K. Bhattacharya and S. C. Kuchhal, "Joint Sector: Guidelines for Policy," *Economic and Political Weekly*, December 9, 1972.
42. R. C. Dutt, "The Joint Sector Organisation", in A. M. Chakraborti (Ed.), *The Joint Sector*, New Delhi, ICSI, 1974, p.49.
43. *Ibid*.

objectives. "The basic justification of the idea of mixed economy is to harness all the productive forces of society, state as well as private, to the task of economic development with a view to accelerating the process. By allowing the private sector to play its part in the process, the state is able to develop entrepreneurship outside the government, and enlist it to supplement its entrepreneurial role. Similarly, a mixed economy allows the state to take advantage of voluntary savings in society for purpose of investment to supplement the resources it is able to mobilise for this purpose".[44]

***(v) Broadbasing of Entrepreneurship*:** Another advantage of the joint sector is that it helps broadbase entrepreneurship by encouraging new and small entrepreneurs. The joint sector enables potential entrepreneurs with small financial resources and less experience to participate in large enterprises as the public sector shares investment and the risk. "Many private entrepreneurs, whose means are not comparable with those of large companies, may come forward and take advantage of joint sector opportunities because the government's support and facilitating roles are assured to them. There is some evidence of this at the state level, where the industrial development corporations seem to be playing the role of broadbasing entrepreneurship".[45]

Evolution of Government Policy

The concept of the *joint sector* became very popular after the Report of the Industrial Licensing Policy Inquiry Committee was submitted in 1969. However, this is not a new idea. The industrial policy pronouncements even before the Dutt Committee Report had conceived the idea of the joint sector. Indeed, the joint sector as a form of business existed in India even before Independence.

The idea of the joint sector was implicit in the Industrial Policy Resolutions of 1948 and 1956. The Industrial Policy Resolution of 1948 indicated the possibility of the state securing the co-operation of private enterprise for the establishment of new units even in the six industries where only the state was to have the right to set up new units, subject to such control and regulation as the Central Government might prescribe. The Industrial Policy Resolution of 1956 indicated "the possibility of the state securing the co-operation of private enterprises in the establishment of new units when the national interest so requires" in the industries listed in Schedule A (i.e. industries, the future development of which had been exclusively reserved for the state). The Resolution also made it clear that, "whenever co-operation with private enterprise is necessary, the state will ensure, either through majority participation in the capital or otherwise, that it has the requisite power to guide the policy and control the operations of the undertaking". It was stated that when the state granted financial assistance to the private sector, "such assistance, especially when the amount involved is substantial, will preferably be in the form of participation in equity capital, though it may also be, in part, in the form of debenture capital".

---

[44] *Ibid.*

[45] Samuel Paul, *et al., op. cit.*

Some laconic references to the joint sector concept may be found in the Five Year Plan documents, beginning with the First Five Year Plan. The Second Plan (1956-61) observed, for instance, that "public ownership, partial or complete, and public control or participation in management are specially required in those fields in which technological considerations tend towards concentration of economic power and wealth".

The Companies Act, 1956, contains provisions relating to government companies under which equity in such companies can be shared by Central and State Governments and private parties. The Companies Act defines a government company as a company in which not less than fifty-one per cent of the paid-up share capital is held by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments, and includes a company which is a subsidiary of a Government company thus defined. The Companies Act, by the definition of the government company, recognises the possibility of joint participation in the equity of a company by the state and private parties (including general public) in the proportion of 51 : 49 respectively in extreme cases.

The concept of the joint sector received greater attention after the Industrial Licensing Policy Inquiry Committee's (ILPIC) Report. The Dutt Committee, in its Report, which followed the unpleasant disclosures made by the Monopolies Inquiry Commission and Professor Hazari, viewed the joint sector as an important means of curbing the increasing concentration of economic power". The Committee also felt that the joint sector "is likely to be more effective than licensing" for the attainment of this objective.

The ILPIC recommended that public financial institutions should have the option to convert the whole or part of their financial assistance to private enterprises into equity so as to bring such enterprises in the joint sector in the mainstream of social interest. The Committee observed: "We consider it important that when public sector financial assistance on any significant scale is provided for the private sector, not only should an appropriate share in the benefits accruing from the project after it is completed be available to the state, but the project should also necessarily be treated as belonging to the "Joint Sector", with proper representation for the state in its management. This purpose may be achieved by the financial institutions insisting on the whole or part of their assistance in the form of loans and debentures being convertible into equity at their option and, if necessary, the law should be amended to provide for this. It also follows that equity holdings of various public financial institutions, the most notable among them being the LIC and

UTI, should be effectively used for enlarging the role of the state in the management of private sector industry."

Following the guidelines issued by the government in 1971, the all-India industrial financial institutions have been reserving the right of converting a part of their loans into equity.*

Accoridng to the Press Note issued by the Ministry of Industrial Development in February 1970, the government accepted the joint sector concept, taking into consideration the recommendations of the Dutt Committee. According to the Press Note, the joint sector was expected to function in two broad areas, viz., the *core sector*, excluding those industries illustrated in 'Schedule A' of the Industrial Policy Resolution, and the *heavy investment sector*, with investment exceeding Rs. 5 crores. The core sector consists of basic, critical and strategic industries. In the Press Note issued in February 1973 on government's decision on industrial policy, it was specifically clarified that "the joint sector will not be permitted to be used for the entry of larger houses, dominant undertakings and foreign companies in industrial in which they are otherwise precluded on their own. In all the different kinds of joint sector units, the government will ensure for itself an effective role in guiding policies, management and operations, the actual pattern and mode being decided as appropriate in each case."

The Concept of National Sector

In early 1975, Mr. T. A. Pai, the then Union Minister for Industries, suggested the replacement of the public sector by that of the national sector. For the establishment of the national sector, Mr. Pai proposed that the public sector undertakings might sell 49 per cent of their shares to the public. He advocated that the shares should be sold, as far as possible, to workers and middle-income groups.

This proposal came in for scathing criticism on the ground that it would facilitate the penetration of private capitalists into the public sector. But a national sector in which workers and the middle class have a considerable stake might be expected to work more efficiently than the public sector. This concept, however, is gaining much acceptance now.

CO-OPERATIVE SECTOR

In India, the co-operative sector has been assigned an important role in the development of may sectors. The First Five Year Plan envisaged the co-operative sector to cover a number of vital areas like agriculture, rural and small-scale industry, retail distribution, housing etc. *The important objectives of the development of the co-operative sector are prevention of concentration of economic power, wider dispersal of ownership of productive resources, active involvement of people in development programmes, augmentation of the productive resources and speedier economic development, liquidation of unemployment and poverty, etc.*

---

* The policy of conversion of loans into equity has been scrapped by the new industrial policy.

One of the important aspects of the development of the co-operative sector in India, as in a number of the other countries, is *state participation*.

According to Weerman, the following are the main background factors or influences which lead to a relationship between the state and co-operatives in developing countries[46]:

(i) The need to give legal recognition to co-operative societies and to provide for their proper management and supervision in the interest of the movement;

(ii) The need to safeguard the rights of the people *vis-a-vis* these societies;

(iii) The need to prevent any abuse or privileges accorded to co-operatives; and

(iv) The need to promote the movement because

 (a) It is, *per se*, desirable and nobody other than the government is likely to take the initiative in promoting it;

 (b) It is the best means of national development;

 (c) It solves the problem of lack of leadership and local personnel for the diffusion of new ideas and techniques.

The important ways in which the state patronises the co-operative movement in India are: State partnership in the share capital of co-operatives; loans to societies; subsidies and grants; guarantees; contribution to risk fund; tax concessions; legal concessions and sanctions; training and education; help from the Reserve Bank and other banking organisations that help the co-operatives; and supply of government officers on deputation.

The co-operative idea took a concrete shape in India for the first time in 1904, when the Co-operative Credit Societies Act — a measure designed to combat rural indebtedness and provide for the registration of credit societies — was passed. Later, in 1912, the Co-operative Societies Act provided for the registration of non-credit societies as well as federations of co-operatives. Since then, the co-operative movement has made progress, especially in the fields of agricultural credit, marketing and processing of agricultural produce, supply of farm inputs and distribution of consumer goods. By far the largest number of societies are in the agricultural credit sector. The primary agricultural credit societies cover over 96 per cent of the rural areas.

Processing and Industrial Co-operatives

Our industrial policy statements have emphasised the role of the co-operative sector in the industrialisation of the country, especially by developing cottage, village and small-scale industries. In the large and medium industries sector, certain agro-industries like sugar, jute and cotton have been considered to be ideally suited for the co-operative sector. The Government of India has recently announced that new sugar factories will be allowed only in the public and co-operative sectors.

---

[46] Cited in Purusha Shetty, *State Participation in Corporation* (a Dissertation submitted in partial fulfilment of the requirement for the Degree of Master of Arts in Co-operation, University of Mysore, Mysore, 1981).

Today, there are about 45,300 industrial co-operatives with a membership of nearly 2.5 million. The National Federation of Industrial Co-operatives assists in the marketing of the products of member societies.

The structure of processing units established in the co-operative sector conforms to two distinct patterns, namely,

(a) Units established by independent processing units; and

(b) Units established as adjuncts to co-operative marketing societies.

Under the first category fall the larger units, such as co-operative sugar factories, spinning mills and solvent extraction plants. Medium and small units, such as rice mills, oil mills, cotton ginning and pressing units, jute baling units, etc., fall under the second category. Of 2,340 processing units organised until the end of March 1979 in the co-operative sector, 1,862 were installed of which 343 were large and medium size units. Over 1,519 units were established as adjuncts to marketing societies. 167 sugar factories have formed themselves into 8 State Federations and a National Federation. The co-operative sugar factories account for over 50 per cent of the country's total sugar production. At the national level, the National Federation of Co-operative Sugar Factories renders advice and maintains a technical cell. It has helped in organising the National Heavy Engineering Co-operative Ltd., for the manufacture of the machinery required by the sugar industry. The NHEC has decided to diversify its activities and has planned to manufacture machinery required by oil, cement and paper industries.

In the field of cotton ginning and pressing, the co-operatives handle nearly 20 per cent of the total production in the country. The spinning mills organised at the national level into the All-India Federation of Co-operative Spinning Mills Ltd. The Federation is a promotional and developmental organisation and provides consultancy services for the establishment of new mills and for the expansion of existing mills. It also assists the spinning mills in their modernisation programmes by helping them in the selection and purchase of machinery, examination of working plants and processing and selection of technical personnel, standardization of accounting methods, etc. The Federation maintains a pool of key personnel for its member mills with a view to providing comprehensive technical expertise for their management.

The Indian Farmers Fertiliser Co-operative Ltd. (IFFCO) is a unique venture of the co-operative movement in India in the field of large-scale fertilizer manufacture. It is the leading producer of fertilizer in the country, its share in the national production being 10 per cent in terms of nitrogen and 22 per cent in terms of phosphates. Registered in 1967 with the support of the co-operatives in the country and the Government of India with the objective of manufacturing and marketing fertilizers for the benefit of farmer members of affiliated co-operatives, the membership of IFFCO covers about 27,000 co-operative institutions, ranging from the national level federations to the village level co-operatives in the State and Union Territories. The IFFCO is now engaged in some important expansion programmes.

The marketing strategy of the IFFCO revolves around selling the concept of modern farming technology instead out of just the fertilizer alone. For this purpose, it operates through a field force of highly trained and motivated agricultural technologists, who function at the grassroots level in the villages and organise practical demonstrations in the use of balanced fertilizers, improved seeds and other inputs, as also assisting in soil testing and in obtaining credit from co-operative societies.

Storage, Distribution and Marketing Co-operatives

The National Co-operative Development Corporation is responsible for the planning, promotion and financing of the programme of augmenting the storage capacity of the co-operatives at various levels. There are over 21,000 rural godowns and over 5,100 marketing godowns. There are also a number of cold storage units.

Co-operatives in India play a significant role in the distribution of agricultural inputs, such as fertilizers, seeds, pesticides, agricultural implements and credit. Nearly 55 per cent of the total fertilizers distributed in India are sold through the co-operative distribution system. The co-operatives have also diversified their activities in recent years to cover new lines of business, like the production, processing and distribution of improved agricultural implements and the setting up of agro-service centres."*

The co-operative marketing structure consists of about 3,400 primary co-operative marketing societies, covering all the important agricultural markets in the country — 369 district regional marketing societies, including 207 sugarcane supply marketing federations and cane unions, 27 State level co-operative marketing federations and one National Agricultural Co-operative Marketing Federation.

The National Agricultural Co-operative Marketing Federation (NAFED), which represents about 3,400 co-operative marketing societies in the country, promotes inter-State and export trade of farm produce. It exports commodities like onions, pulses, chillis, ginger, garlic and cardamom to Australia, Belgium, Canada, Fiji, Hongkong, Japan, Malaysia, Mauritius, Singapore, Sri Lanka, the U.K., the USA and a number of African, West Asian and Gulf countries. Export of pulses, onions and potatoes is canalised through the NAFED, which also undertakes the movement of essential commodities from surplus areas to scarcity areas, and helps to ease consumer distress.

---

* For the role of co-operatives in the Public Distribution System, see the chapter on *Price and Distribution Controls*.

NAFED has entered into the marketing of fresh fruits, mainly apples, and also vegetables to help growers in underdeveloped hilly regions in the north and south-eastern parts of the country. It has set up two fruit and vegetable processing units, one in the North and one in the South, and the products of NAFED have become quite popular. The Federation has established branches in all major port towns and capital cities in the country.

Functional Co-operatives

Co-operatives for the weaker sections of society provide increased employment and income opportunities to different sections of the community, such as small and marginal farmers and fishermen. Functional co-operatives for dairy, fishery and poultry mainly relate to the service of the weaker sections.

There are nearly 30,000 primary housing co-operatives in the country, and they have constructed nearly 4.5 lakh houses.

Multi-Purpose Co-operatives

As part of the programme of economic development of tribals, primary co-operatives in tribal areas were reorganised to enable them to function as multi-purpose societies providing short, medium and long-term credit to tribals, undertaking collection and marketing of agricultural and minor forest produce, arranging for supply of agriculture inputs as well as essential consumer goods. State level co-operative tribal development corporations/federations have been established in Andhra Pradesh, Bihar, Madhya Pradesh, Maharashtra, Rajasthan, West Bengal and Orissa to serve as apex organisations for the marketing of minor forest produce and consumer goods.

National-Level Co-operative Federations

A major development over the past one decade has been the emergence of national co-operative federations which have added a new dimension to the co-operative infrasructure. With the National Co-operative Union of India at the apex, the other national-level co-operative organisations, include the National Agricultural Co-operative Marketing Federation, the All-India State Co-operative Banks Federation, the National Federation of Co-operative Sugar Factories, the National Co-operative Land Development Banks Federation, the National Co-operative Consumer's Federation, the National Federation of Industrial Co-operatives, the All-India Federation of Co-operative Spinning Mills, the National Co-operative Housing Federation, the National Co-operative Dairy Federation of India and the National Federation of Co-operative Urban Banks and Credit Societies.

In the context of a national pattern which is being evolved, the system of workers' participation in management is being introduced in large co-operative industrial units. Special co-operative programmes directed towards increasing employment and income opportunities for the vulnerable sections have been evolved and are being implemented. The National Co-operative Development Corporation has also extended its activities to cover co-operative programmes for weaker sections.

Problems

While the overall progress of the co-operative movement appears to be striking, there are wide regional disparities. The level of development of agricultural co-operatives is not uniform in all the states. A number of schemes have been evolved with financial assistance from the Central Government to accelerate the growth of agricultural co-operatives in those states where its progress has been slow.

Another aspect that is currently receiving attention is the review of State co-operative laws with a view to overcoming the reported restrictive features of co-operative legislation which tended to prevent the quick growth of co-operative laws. The aim is to blend the principle of democratic control with the self-reliance of the co-operative movement.

Consultancy Services

With a view to provide expert management advice and guidance to consumer co-operative institutions in improving their business operations and managerial efficiency, a Consultancy and Promotional Cell was established in 1972 by the NCCF with financial support from government. The activities of the cell have been further expanded under the ILO/SIDA Technical Assistance Programme under which services of ILO experts are made available to the Consultancy Cell in various fields of consumer co-operatives management, besides the training facilities abroad for Indian counterparts on techniques of management.

14

Privatisation

Privatisation, which has gathered momentum since around the 1980 has become the hallmark of the new wave of economic reforms sweeping across the world. More than 8,500 state owned enterprises have been privatised in over 80 countries during 1980-92.

Privatisation means transfer of ownership and/or management of an enterprise from the public sector to the private sector. It also means the withdrawal of the State from an industry or sector, partially or fully. Privatisation marks a change from dogmatism to pragmatism and amounts to a reversal of policy.

The trend towards privatisation has been observed in developed and developing economies; in market oriented and socialist, including communist countries; and cuts across socio-cultural systems.

Expansion of Public Sector and its Defects

In the 1960s, there was a trend towards nationalisation in Britain. But since the late 1970s, the trend has been towards privatisation by selling State-owned enterprises (SOEs). Besides the U.K., countries, which have sold or announced the policy of sale of SOEs in the recent years include Argentina, Bangladesh, Brazil, Britain, Federal Republic of Germany, France, Italy, Japan, Mexico, Nigeria, Spain, Thailand and Turkey. A number of other countries, including India, have deregulated or liberalised the Industrial sector in varying degrees. Besides China, which started privatisation in the late 1970s, privatisation has spread to other communist countries like former USSR, East European countries and Cuba.

As professor Berg rightly remarks, the privatisation response is in a real sense a reaction to the worldwide growth of government. The rapidity with which the public sector in many countries expanded over the last two decades, roughly in the period from 1960 to 1980, is frequently overlooked.

In effect a revolution, a quiet one, occurred in the shifting of resources into the public sector in the decade of the 1970s. In the less developed countries and in many of the poorest countries, the growth of the public sector was characterised by the growth of the Parastatal sector—State-owned enterprises. State-owned enterprises now account for 10 to 20 per cent of GDP in much of the less developed world, and they are dominant in manufacturing in a great number of countries. What is true for GDP is also true for capital investment. Parastatal enterprises are estimated to be responsible for between 20 and 60 per cent of total investment spending in the less developed world. Regardless of whether socialist or market-oriented, virtually all countries in the 1960s and 1970s saw an expansion of the public sector, and in particular an expansion of state-owned enterprises, across a broad front.[1]

The performance of SOEs in many countries have, by and large, been far from satisfactory. They have often put large burdens on public budgets and external debt. For example, the net deficit of a sample of SOEs accounted for about 4 per cent of Niger's GDP in 1982. For the seven largest Latin American economies, the combined deficit of SOEs rose from about 1 per cent of GNP in the mid-1970s to about 4 per cent in 1980-82. One study has found that countries in which SOEs accounted for higher shares of gross domestic investment generally had lower rates of economic growth.[2]

The heavy financial burden imposed by the SOEs and the growing public discontent against them due to their inefficiency; indifferent, irresponsible and sometimes even arrogant attitude and lack of concern for the customer needs; and corruption, nepotism and squander associated with their organisation and management have led to the growing interest in privatisation. As Professor Samuel Paul points out[3], in country after country, unbridled state expansion has led to:

(i) economic inefficiency in the production activities of the public sector, with high costs of production, inability to innovate, and costly delays in delivery of the goods produced;

(ii) ineffectiveness in the provision of goods and services, such as failure to meet intended objectives, diversion of benefits to elite groups, and political interference in the management of enterprises; and

(iii) rapid expansion of the bureaucracy, severely straining the public budget, causing problems in labour relations within the public sector, inefficiency in government, and adverse effects on the whole economy. These problems have led many governments to undertake programmes of public sector reform, and pushed by a need to curb public expenditure, to reevaluate the possibilities for shifting publicly managed activities into the private sector.

---

[1] Elliot Berg, "Privatisation: Development a Pragmatic Approach," *Economic Impact*, 1987/1, pp. 6-7.

[2] World Bank, *World Development Report* 1987 (Washington D.C., World Bank, 1987), p. 67.

[3] Samuel Paul, "Privatisation and the Public Sector," *Finance and Development*, December 1985, p. 42.

The Privatisation Reaction

Privatisation is an inevitable historical reaction to the indiscriminate expansion of the State sector and the associated problems. Even in the 'communist' countries it has caught on as an import measure of economic rejuvenation. Referring to the privatisation movement, a Russian periodical observes: "The crisis of the state sector is usually linked (in particular, during ideologically tinged debates) with the 20-year-old idea of "peoples capitalism." It is attributed to the then West German Chancellor Ludwig Erhard, who advocated the principle of increasing the number of owners as a way towards economic democratisation and social progress. Apparently, others also lay claim to the idea. However, more importantly, the idea has had followers: Margret Thatcher, Jacques Chirac and lesser known politicians. It is very significant that although they have been labelled "conservative" at least in their life time, these politicians, more than anybody else, sought to change the existing economic machinery, and not to preserve it. Besides, they tried to do so not by returning to the "early days of capitalism," when property was concentrated in the hands of select few, but by distributing shares among ordinary people.[4]

The article referred to above exalts: "When hundreds, thousands and even millions of people in the USSR have shares in their hands, they will be able to see for themselves how the Western model of "the right to vote" and "the right to leave" works. Owners (surprise, surprise to a lathe or crane operator) can interfere in the company's affairs and say openly what they like and what they don't like. When their protests are ignored, they can sell their shares and leave the company.

"It is going to be a real surprise to many, but this precisely what we have been looking forward to — the right to voice one's opiniong and the right to leave."[5]

It may be noted that as a result of privatisation the number of people owning shares in Britain almost tripled from 7 to 20 per cent of the adult population between 1978-89. Interestingly, in 1988 Britain experienced a symbolic cross over — for the first time in history more British citizens were holders of shares than were members of unions.[6] Further, as the proportion of shareholders in the total population increases and as the economic lot of the workers and the poor improves, leftist parties increasingly lose their ground. In 1988, for instance, the Labour Party in Britain lost 8 per cent of its members, the biggest exodus since 1981.[7]

---

[4] Alexander Polyukhov, "Everything for Sale," *New Times*, October 2-8, 1990, p. 31.

[5] *Ibid.*, p. 32.

[6] Naisbitt and Aburdene, *op.cit.*, p. *162*.

Ways of Privatisation

There are different ways of achieving privatisation. "Each country has its own gimmicks. In Britain, the staff of the privatised company have a priority in buying shares, and are entitled to a discount. For instance, 96 per cent of British telecom employees took a share in their company in defiance of the trade union opposition. Although some of them later sold them (at a higher rate), they derived certain benefits (at least financial ones) from privatisation. The use of the U.S. ESOP (Employees' Share Ownership Plan) practices is another interesting example. ESOP provides for forming special fund which takes bank credit to buy a company's shares and distribute them among employees at the real value or free of charge. The credit is paid back out of the company's profit."[8]

One of the important ways of privatisation is *divestiture*, or privatisation of ownership, through the sale of equity. In countries where there are well functioning capital markets, this entails selling stock to the public. In industrial countries, privatisation has come mainly through divestiture of government economic activities. Among the developing countries, Bangladesh, Chile, Jamaica, Brazil, Peru, Zaire, Pakistan, the Philippines and Sudan offer examples of divestiture.

Japan has a century-old history of divestiture. After an initial attempt to promote industrialisation through state ownership, the Japanese government in the 1880s sold many state firms, including 52 factories, 10 mines and 3 shipyards. Privatisation has assumed importance in Japan in 1980s too. On the recommendations made by an administrative reforms committee consisting of experts and businessmen, Japan has recently made legislation which enables the privatisation of two of the most lucrative state enterprises, namely, Nippon Telegraph and Telephone and Japan Tobacco and Salt Corporation. The objective is to reduce government expenditure and raise administrative efficiency by withdrawing government presence from areas which can be managed better by private people. Divestiture has become so common in the Western Europe that "hardly a week or month goes by without some new evidence of sale of state enterprise by such Western European countries as France, Italy, Sweden, the Federal Republic of Germany, and, of course, the champion industrial company privatizer, Britain."[9]

In the Republic of Korea, the government pioneered the establishment of basic industries such as oil refining, steel, and machine tools and then sold them to the private sector once their profitability was established, using the funds raised to pioneer other industries: Brazil created a commission for divestiture in 1981 and Jamaica set up a divestiture committee.

---

[7] *Ibid.*, p. 160.

[8] Alexander Polyukhov, *op. cit.*, p. 31.

[9] Elliot Berg, *op. cit.*, p. 8.

There are a large number of cases where privatisation has taken the form of *denationalisation or reprivatisation*. A considerably large number of enterprises were denationalised in countries like Chile, Bangladesh and Pakistan.

Another way of privatisation is *contracting*. Governments may contract out services they have planned and specified to other organisations that produce and deliver them.

Franchising—authorising the delivery of certain services in designated geographical areas — is common in utilities and urban transport. Contracting is common in public works, defence and many specialised services. Where suppliers compete for contracts and there is no loss of economies of scale, contracting is efficient. But there is scope for corruption in contracting, and long-term contracts tend to encourage monopolistic behaviour by the private supplier. Contracts for road construction and maintenance are common in countries such as Brazil, Colombia, India, and Kenya. In agriculture and urban development in the Philippines and in water supply in the Ivory Coast, private contracts have played an important role.[10]

Another option for the government is to *withdraw* from the provision of certain goods and services leaving them wholly or partly to the private sector.

Privatisation may also take the form of *privatisation of management*, using *leases* and *management contracts*.

Government can shed the burden also by *liquidation* which can be either formal or informal. Formal liquidation involves the closure of an enterprise and the sale of its assets. Under informal liquidation, a firm retains its legal status even though some or all of its operations may be suspended.

Obstacles

When compared to the industrial countries, the progress of privatisation has been slow in the LDCs. As the World Bank points out, governments confront several obstacles, like those mentioned below, when they decide to divest SOEs.[11]

(i) Governments usually want to sell the least profitable enterprises, those that the private sector is not willing to buy at a price acceptable to the Government.

(ii) Divestiture tends ~~to~~ arouse political opposition from employees who may lose their jobs; from politicians who fear short-term unemployment consequences of liquidation or of cost reduction by private owners; from bureaucrats who stand to lose patronage; and from those sections of the public that fear that national assets are being cornered by foreigners, the rich, or a particular ethnic group.

---

[10] Samuel Paul, *op. cit.*, p. 43.

[11] World Bank, *op. cit.*, p. 68.

(iii) Relatively undeveloped capital markets sometimes makes it difficult for governments to float shares and for individual buyers to finance large purchases.

Conditions for Success of Privatisation

Professor Samuel Paul points out that if privatisation is to succeed, in the sense of raising efficiency or effectiveness in the production or delivery of goods and services, the following seven conditions must be met.[12]

First, privatization cannot be sustained unless the political leadership is committed to it, and unless it reflects a shift in the preferences of the public arising out of dissatisfaction with the performance of other alternatives. Privatization has in the past worked best when a government was strongly committed to a change, or when a new government vowed to reverse the actions of its predecessors, as has happened in Chile and the United Kingdom. More recently, some governments that have faced severe economic crises, with massive budgetary deficits, have turned to privatization and divestiture as a part of their adjustment strategy.

Second, any alternative institutional arrangements chosen should not stifle competition among suppliers. Replacement of a government monopoly by a private monopoly may not increase public welfare—there must be a multiplicity of private suppliers. This can be a difficult problem where there are few competent suppliers. Though government may wish to contract out a service, if there are only one or two qualified contractors, the benefits of competition are unlikely to follow.

In this context, most developing countries' systems of regulation need major review and reform. Overregulation of industry discourages private initiative; overregulation of urban land use of building construction retards urban development; and unduly low ceilings on the prices of industrial products and utilities, such as bus transport and electricity, inflate demand and depress the incentives for production.

The third, related, condition is freedom of entry to provide goods and services. Long-term contracts and franchises limit competition and consumers' choice. In some services that are capital intensive, freedom of entry is difficult to achieve. But in others, such as refuse collection or health services, the public will be better served by several private suppliers competing than by one agency monopolizing the market through a long-term contract.

---

[12] Samuel Paul, *op. cit.*, pp. 44-45.

Fourth, public services to be provided by the private sector must be specific or have measurable outcome. Physical construction or utility services, for example, can be measured, but most educational services and police protection are not easy to quantify, even though their inputs can be measured. Lack of specificity makes it more difficult to control services provided by the private sector, especially if the public served is illiterate, unorganized, and unassertive. Service delivery by non-governmental organisational or local governments may be more appropriate under these conditions.

Fifth, consumers should be able to link the benefits they receive from a service to the costs they pay for it, since they will then shop more wisely for different services. User charges are one way of establishing this link. The importance of educating consumers and disseminating information to the public cannot be overemphasized here.

Sixth, privately provided services should be less susceptible to fraud than government services if they are to be effective. Services provided through collective or cooperative action at the community level are probably the least susceptible to fraud.

Seventh, equity is an important consideration in the delivery of public services. Broadly speaking, the benefits of privatisation can accrue to the capital owner who supplies the service; to the consumer, who receives a more efficient service; and to the public at large, through a reduction in the public sector deficit, and hence in taxes or the rate of inflation, or both. Privatisation will be counter-productive if the ability of the public to pay, determined by the prevailing income distribution, becomes the sole guide for the delivery of services. And, if the benefits of privatization are likely to be reaped solely by local elites, expatriate groups, or multinational corporations, political resistance to reform is likely to increase.

Benefits of Privatisation

Privatisation benefits the society in several ways. The fact that privatisation is an important strategy of economic rejuvenation of even the 'communist' nations is a testimony to the economic role of privatisation. Countries like the U.K. have shown how it could help solve the fiscal crisis of the State and to usher in a new industrial democracy. The benefits of privatisation may be listed down as follows:

(i) It reduces the fiscal burden of the State by relieving it of the losses of the SOEs and reducing the size of the bureaucracy.

(ii) Privatisation of SOEs enables the government to mop up funds.

(iii) Privatisation helps the State to trim the size of the administrative machinery.

(iv) It enables the government to concentrate more on the essential State functions.

(v) Privatisation helps accelerate the pace of economic development as it attracts more resources from the private sector for development.

(vi) It may result in better management of the enterprises.

(vii) Privatisation may also encourage entrepreneurship.

(viii) Privatisation may increase the number of workers and common man who are shareholders. This could make the enterprises subject to more public vigilance.

Privatisation in India

In India, although there were some isolated cases of privatisation, no definite policy decision was taken until recently when the new economic policy has been ushered in.

In India, the public sector, both the Central as well as State, expanded indiscriminately and it was extended to nonpriority sectors and sectors where the private sector would perform better. Populist political appeal and vested interests of politicians and bureaucrats contributed to this. State governments set up public corporations after corporations to expand the empire of the political parties and to give berths to political leaders.

The accumulated losses of many SOEs, including some state transport corporations, are larger than the capital invested in them. These public sector deficits compel governments to increase taxation and curtail development expenditures. There is no justification for imposing such burden on the public by the state carrying out activities which the private sector can do more efficiently. Privatisation of certain sectors and enterprises are, therefore, necessary to reduce the budgetary burden on the public, to make available more resources for the development activities, to enable the government to concentrate more on the essential government functions and priority areas and to relieve the consumers from the indifferent and arrogant attitude of the public sector.

Road transport is an area where privatisation can be easily carried out in a phased manner. When numerous private parties can more efficiently operate the road transport, what is the justification for harassing the passengers and burdening the public with the losses they incur? There will, of course, be opposition from political parties and trade unions. A major reason for political opposition is the 'harvest' that will be lost. It is often said that there are large kick-backs in the large-scale purchases of the corporations and huge amounts are collected for appointments to various positions.

The government should withdraw from areas where private enterprises will be more efficient. Now that the nation has achieved a certain level of industrial development and private entrepreneurship is plenty, the State should curtail its entrepreneurial role and concentrate its resources on the promotional and regulatory role (here regulation means regulation of the conduct of the business, and not the type of growth defeating hassles we have had).

The State has no moral right to impose financial burden on the citizens by running inefficient enterprises. It is time that we in India pondered over the issues: Should we continue to be burdened with the loss of the State running luxury hotels and buses and making soaps, detergents, cosmetics, bread and a variety of other products which can be better done by the private sector? Don't we have a right to better alternatives to public sector monopolies? (Indeed right to choice is a well accepted consumer right. One of the objectives of the consumer Protection Act, 1986, is "the right to be assured, wherever possible, access to a variety of goods at competitive prices"). Should not the state concentrate more on the effective discharge of its essential functions and on dealing with the priority issues than laying its hands on everything, creating an unwieldy gamut of activities, wasting the scarce resources and putting more burden on the weary shoulders of the common man?

The new industrial policy which abolishes the public sector monopoly in several industries (Only eight industries are now exclusively reserved for the public sector as against 17 industries in Schedule A previously) is a significant step towards privatisation. Industries which are thus opened for the private sector include iron and steel; power; ship building; telephone and telephone cables; telegraph and wireless apparatus; aircraft; air transport, and heavy plant and machinery. The scrapping of the Schedule B which contained a list of 12 industries where public sector was to play a dominant role is also an important policy change.

It has been reported that the government is thinking of throwing open to the private sector according to the industrial policy announced on July 24, 1991, except arms and ammunition and allied items of defence equipment; atomic energy; and minerals specified in the schedule to the atomic energy. In other words, the policy is to abolish the monopoly of any sector in the field of manufacture, except on strategic or military considerations, and open all manufacturing activity to competition.

The new policy also proposes privatisation of enterprises by selling shares to mutual funds, workers and the public. The Central government is also reported to be reviewing the existing portfolio of public investment with a view to offloading public investment from areas where the following conditions prevail: (i) industries based on low technology; (ii) small-scale and non-strategic areas; (iii) inefficient and unproductive areas; (iv) areas with low or zero social responsibility or public purpose; and (v) areas where private sector had developed sufficient expertise and resources.

However, to what extend the government will push through the proposals in the face of trade union and political opposition is to be seen.

Further, transfer of part of the shares to public financial institutions does not represent true privatisation. Further, unless the privatisation of a unit is not substantial, it is not going to be meaningful.

As stated in a previous chapter, both the Central and State governments appear to be fluttering and faltering with the issue of privatisation in the absence of a clear view, strong determination, political will and a perspective view.

The policy reforms, however, has set the stage for privatisation. For instance, even if the government will shy away from privatisation of the banking sector is likely to take place by rapid growth of existing private sector banks, establishment of new private sector banks and expansion of business of the foreign banks.

Partial privatisation of industrial undertaking may also take place by turning public sector units into joint ventures by private participation as has been proposed in the case of several units of the Keltron.

Of course, privatisation by itself does not guarantee success. What are sought to be achieved are accountability, enterprise and proper management. True, many private enterprises are inefficient and sick; but that is no excuse for the State to waste its resources and impose burden on the common man by engaging in businesses which can be efficiently done by the private sector.

15

Village, Small and Ancillary Industries

The importance of the need to promote the development of the small industries sector have been emphasised by all the industrial policy resolutions and statements and a number of protective and promotional measures have been taken accordingly to ensure their survival and to encourage their growth.

The VSI Sector

The village and small industries (VSI) sector in India consists broadly of : (i) traditional cottage and household industries (viz., handloom, khadi and village industries, sericulture, handicrafts and coir) and (ii) modern small-scale industries including tiny units and powerlooms. While traditional industries are generally artisan based, located mostly in rural and semi-urban areas, involve lower levels of investment in machinery and provide largely part-time employment, modern small-scale units and powerlooms use mostly power operated appliances and machinery, have some technological sophistication and are generally located close to or in the urban areas including large industrial centres. However, as a part of the industrial dispersal policy and rural industrialisation, governments have been encouraging modern small-scale units in rural areas.

There has also been an increase in the variety of products manufactured by the small-scale sector. They have ventured into the manufacture of many new and sophisticated items. The small-scale industries today produce more than 5000 items.

It is estimated that between 1974-75 and 1994-95, the number of small-scale units (excluding khadi and village units) increased from less than 5 lakhs to about 27 lakhs; employment increased from about 40.5 lakhs to nearly 147 lakhs and value of output increased from about Rs. 9,200 crores to 2,93,990 crores. The small-scale units contribute about 40 per cent of the total industrial output and about 35 per cent of the total export earnings.

Importance

The khadi, village and small-scale industries have a very important role in the Indian economy characterised by its vast spatial spread, unemployment and underemployment, rapidly rising labour force, capital scarcity, numerous market segments and diverse demand pattern, broad and diverse resource base and supply, predominance of widely scattered numerous village settlements, growing modern large industrial sector giving scope for ancillarisation and so on.

The distinguishing features and major advantages of these industries, particularly khadi and village industries, are the following :

(1) In an economy, like India, characterised by abundant labour supply and the concomitant unemployment and underemployment and rapidly rising labour force, khadi, village and small industries assume special significance because of its high employment potential.

(2)Another major advantage is their ability to provide employment in the off-season. To a large number of people, agriculture provides only seasonal employment. Khadi, cottage and some other village industries provide employment opportunities during the off-season and help many households to mitigate their problems during the off-season.

(3) Khadi, cottage and certain other village industries provide vast scope for employment of special categories of people like women, children, old aged, physically handicapped, etc. It is also an avenue for part-time employment for those who are employed elsewhere, either full-time or part-time.

(4) Some of these industries provide employment opportunities within the household premises and some others near the place of residence. The locational advantage of these industries are, thus, very great.

(5) A major advantage of these industries is that the capital-output and capital-labour ratios are comparatively very low. That is, the amount of capital investment required per unit of employment and the capital investment required per unit of output are comparatively very low. In other words, the khadi and village industries in particular and the small-scale units in general maximise employment and output for a given amount of capital. This is of particular importance to a labour-abundant and capital-scarce economy like India.

(6) Because of the low capital-output ratio and low gestation period they promote non-inflationary growth.

(7) Khadi and village industries have been found to be of particular help to the weaker sections of the society. The participation of the scheduled castes, scheduled tribes, women and other weaker sections of the society in this sector is significant.

(8) These industries promote economising of resource utilisation and conservation of resources. They are expected to ensure maximum utilisation of locally available raw materials by adopting easily adaptable techniques. In some cases, non-conventional raw materials are used thereby converting waste into wealth.

(9) These industries can develop in almost all areas including backward, tribal, hilly and inaccessible areas. They are, thus, helpful in achieving wider spatial dispersal of industrial activities and thereby reducing the regional economic imbalances.

(10) They help increase the pace of rural development through the generation of additional employment opportunities and income and through its inputs and output linkages with the other sectors of the rural economy.

(11) The small industries have acquired more attention in recent years due to the very less ecological problems they create, compared to the large industries.

(12) As khadi and village industries do not use or use only very little electric power or oil, they do not cause energy crisis and foreign exchange crisis.

(13) The fact that the village and small industries account for about one-third of our total export earnings shows how important they are to the Indian economy constrained by shortage of foreign exchange.

Development of VISs under the Plans

All our Five Year Plans and Industrial Policy statements have stressed the need to accelerate the development of village and small industries to create large-scale employment opportunities, promote decentralisation and dispersal of industries, achieve diffusion of ownership and prevention of concentration of economic power, promote entrepreneurship, develop agro-based and ancillary industries, improve the skills of artisans and quality of their products, reduce the role of subsidies and to step up the productions of essential articles and those having potential for exports.

The Government, Central and States, have taken a number of measures to solve the age-old problems of these industries, such as lack of credit facilities, outmoded methods and techniques, absence of organised marketing, unsatisfactory arrangements for the supply of raw materials and competition from large-scale units.

The Union Government has set up a number of agencies to foster the development of the VSI. These include the National Small Industries Corporation, the Small-Scale Industries Board, the Khadi and Village

Industries Commission, the All-India Handicrafts Board, the All-India Handloom Board, the Coir Board and the Silk Board.

Apart from these, credit facilities are made available to these industries through a number of institutions. Industrial estates and rural industrial projects have been set up, and industrial co-operatives have been organised. State Directorates of Industries and other agencies are responsible for their development in the States.

Objectives

The objectives of the development of village and small industries, are as following:

(i) to assist in the growth and widespread dispersal of industries;
(ii) to increase the levels of earnings of artisans;
(iii) to sustain and create avenues of self-employment;
(iv) to ensure regular supply of goods and services through use of local skills and resources;
(v) to develop entrepreneurship in combination with improved methods of production through appropriate training and package of incentives; and
(vi) to preserve craftsmanship and art heritage of the country.

Promotional Measures

A number of measures have been taken by the governments, central and state, to protect this sector from the onslaught of the large sector and to promote its growth. They include the following.*

(i) Reservation of products: Market protection is provided to the small-scale units by the reservation of items for exclusive production in the small-scale sector. Over the years there has been an increase in the number of items so reserved and it stood at 835 at the end of January 1989.

(ii) Preference in Government Procurement : Preference is given to the small-scale sector in government procurement. Under this programme, more than 400 items are reserved for exclusive purchase from the small-scale sector while a limited number of items (13 in January 1989) are reserved for purchase upto 75 per cent and a number of items (28 in January 1989) for purchase upto 50 per cent.

(iii) Infrastructural and Institutional Support: Infrastructural and institutional supports are provided through industrial estates, district industries centres (DICs), Small Industries Service Institute, Khadi and Village Industries Commission (KVIC) and other specialised institutions which provide technical assistance, testing facilities, etc.

---

* Also see the section "Institution for Small Industries"; in the chapter on *Industrial Financial Institutions*.

(iv)Machinery on Hire Purchase : The National Small Industries Corporation (NSIC) arranges supply of machines on hire purchase to small-scale units.

(v)Marketing Assistance: Marketing assistances including export promotion assistance are provided by institutions such as the NSIC, the Small Industries Development Organisation (SIDO), Handicrafts and Handlooms Export Promotion Corporation, KVIC etc.

(vi) Financial Assistance : Financial assistance is provided at concessional terms by commercial banks, state level financial institutions, etc. In order to step up the flow of assistance to the small sector and to provide a focal point to coordinate at the apex level the availability of both financial and non-financial inputs required for the orderly growth of this sector, the Small Industries Development Fund (SIDF) was established within the IDBI in 1986.

(vii) Training : Training for existing and potential entrepreneurs and others associated with the working of the small units are offered by Entrepreneurship Development Institute of India (EDII), Technical Consultancy Organisations (TCOs), financial institutions and commercial banks, management institute, NSIC etc.

(viii) Supply of Raw Materials : Arrangements have also been made for the supply of raw materials, particularly of scarce items, to the small-scale units.

(ix) Promotion of Ancillarisation : The Industrial policy also give importance to ancillarisation. This has been recognised as one of the objective of the public sector industry. One of the factors considered by the government while evaluating application from the private sector for industrial licence is the scope for ancillarisation by the proposed project.

KHADI AND VILLAGE INDUSTRIES

Khadi means any cloth woven on handlooms in India from cotton, silk or woollen yarn handspun in India or from mixture of any two or all such yarns.

Industries coming under the purview of Village Industries are : (1) Beekeeping; (2) Cottage Match, manufacture of fireworks and Agarbatties; (3) Cottage Pottery; (4) Cottage Soap; (5) Flaying, curing and tanning of hides and skins and ancillary industries connected with the same and cottage leather industry; (6) Ghani Oil; (7) Handmade paper; (8) Manufacture of cane-gur and khandasari; (9) Palmgur making and other palm products: (10) Processing, packing and marketing of cereals, pulses, spices, condiments, massalas, etc. (11) Manufacture and use of manure and methane gas from cowdung and other waste products (such as flesh of dead animals, night soil, etc.) (12) Lime stone, lime shell and other lime products; (13) Manufacture of shellac; (14) Collection of forest plants and fruits for medicinal purposes; (15) Fruit and vegetable processing, preservation and canning, including pickles; (16) Bamboo and canework; (17) Blacksmithy; (18) Carpentry; (19) Fibre other than coir; (20) Manufacture of household utensils in aluminium; (21) Manufacture of Katha; (22) Manufacture of gums and resins; (23) Manufacture of Lokvastra; (24) Manufacture of Polyvastra; (25) Processing of maize and ragi.

KVIC

The Khadi and Village Industries Commission (KVIC) is a statutory organization engaged in the task of promoting and developing khadi and village industries with a view to creating employment opportunities in the rural areas and thereby strengthening the rural economy. It was established in 1975 by an Act of Parliament. It is an autonomous body which took over from its predecessor, the All-India Khadi and Village Industries Board, set up in 1953.

The broad objectives that the KVIC has set before it are :

(i) the social objective of providing employment;
(ii) the economic objective of producing saleable articles; and
(iii) the wider objective of creating self-reliance amongst the people and building up a strong rural community spirit.

The functions of the KVIC are generally to plan, organise and implement programmes for the promotion and development of khadi and village industries. In particular they include:

(a) training of persons engaged in production of khadi and village industries;
(b) building up reserve of raw materials and implements and supplying them to person engaged in the production of KVIs at economical rates;
(c) to provide for sale and marketing of khadi and products of village industries and handicrafts;
(d) to encourage and promote reasearch in the technique of production of khadi and in the development of village industries, and to provide facilities for study of problems relating to KVIs;
(e) to maintain or assist in the maintenance of institutions for the development of KVIs;
(f) to undertake, assist or encourage production of khadi or development of village industries;
(g) to promote and encourage co-operative efforts among manufactures of khadi and persons engaged in village industries; and
(h) for ensuring the genuineness of and for granting certificates to producers of or dealers in, khadi or the products of any village industry.

The KVIC have created an organisational base for further development with 30 State KVI Boards, about two thousand registered institutions and about 30,000 industrial co-operatives. KVIC has over 11,000 sales outlets in the country. This is an unique national organisation in the country which has its roots in the villages and has wide organisational linkages. Its activities cover over 2.1 lakhs villages in the country. A substantial number of beneficiaries belong to the scheduled caste and scheduled tribes and inhabitants in hill and border areas. The participation of women in the activities is also very high, i.e., 45 per cent.

In 1992-93, the khadi and village industrial units assisted by the KVIC were estimated to have provided employment to nearly 51 lakh people compared to less than 16 lakhs in 1956-57. The output of the KVI sector is estimated to have increased from less than Rs. 21 crores in 1956-57 to Rs. 2,225 crores in 1990-91. For 1993-94 the estimates of production is Rs. 3, 490 crores and of employment is 55.7 lakhs.

ANCILLARY INDUSTRIES

Integration of small and large industries through ancillarisation is an important feature of industrial development of countries like U.S.A. and Japan. In India, the government policy has been one of encouraging ancillarisation.

An ancillary unit is one having an investment in plant and machinery, whether held on ownership basis or by lease or by hire purchase, not exceeding Rs. 75 lakhs and engaged in the manufacture of parts, components, sub-assemblies, toolings and intermediates or the rendering of services or proposing to render, provided 30 per cent or more of their total production or service as the case may be is for other units for production of other articles.

Though all industries are not amenable to ancillarisation, there are a number of industries with scope for considerable ancillarisation. Large industries may benefit from ancillarisation in different ways. One benefit of ancillarisation is the realisation of economies of scale. If the requirement of any item is less than the economic size of production, it stands to gain by purchasing the item from an outside unit of economic size. Further, a large company can relieve itself from the problem of tying up of capital, managerial time, etc., on minor items which can be efficiently produced by ancillaries. The society also benefits from the economies of scale and other efficiencies associated with ancillarisation. As the impact of energy crisis and credit squeeze is comparatively less on small-scale units, ancillarisation offers further advantages to large units in an era of power shortage and financial problems.

Ancillarisation and sub-contracting, however, have some problems also. The parts or components supplied by these units may not sometimes be of satisfactory quality. The small units usually do not have the resources for carrying out research and development. Hence, parent units will have to help them to update technology and enforce strict quality control.

Industrial machinery, agricultural and earth moving machinery; machine tools; industrial; scientific and mathematical instruments; locomotives and rolling stock; ships; aircrafts; bicycles; boilers; steam generating plants; steam engine; automotive parts; turbine; internal combustion engine; commercial, office and household equipment; telecommunication equipment; electronics; electrical equipment; packaging items for use in chemicals; some iron and steel industry items are but some fields where there is good scope for ancillarisation.

The extent of ancillarisation possible in different fields in India is as high as 60 to 90 per cent in transportation industry; 50 to 75 per cent in communications industry and 30 to 50 per cent in prime movers and power based industry. It is 20 to 40 per cent in industrial machinery and machine tools; 15 to 30 per cent in chemicals and pharmaceuticals industry; 10 to 30 per cent in consumption and consumer durable goods industry; and 5 to 10 per cent in basic industry, such as metals, minerals, cement and petroleum. The lowest range is 2 to 10 per cent in wood, paper fibres, glass, ceramics, leather, rubber, etc.[1]

DRAWBACKS AND PROBLEMS

The number of small units have increased remarkably. The role of this sector in the Indian economy cannot be underestimated. However, as the Planning Commission observes, some of the important objectives set for the village and small industries sector are yet to be fully achieved.

The dispersal of small-scale units far away from the metropolitan areas and large cities has not taken place to an appreciable extent. Available data indicate that the industrially developed States account for a very large share of the registered small scale units. Within the developed States, there has been concentration of units in areas which are either metropolitan or large cities or industrial complexes.

Though accurate estimates are not available, industrial sickness appears to be widespread in the small-scale sector.

A number of promotional measures designed to develop the VSI sector have not produced the expected results. For example, the Entrepreneurial Development Programme has not made significant progress except in a few States like Gujarat in widening the entrepreneurial base.

Low levels of technology resulting in poor productivity and inadequate returns continue to characterise the traditional industrial sector.

It has been pointed out that a number of the registered small-scale units are bogus; they have been registered to avail the credit and other facilities offered to this sector. There is deliberate diversion of resources from the genuine use. Units are deliberately made sick after swindling the credit amount.

---

[1] "Ancillarisation in Indian Industry", *Economic Trends*, 16 July, 1981.

Though a number of arguments are put forward in favour of the VSI sector, in a number of cases the VSI units are promoted and sustained at a heavy social cost. The enormous subsidies they are granted, like concessional finance, fiscal incentives, price preferences, etc., have to be borne by the society.

The earning levels of a large number of people employed in the VSI sector, especially in the traditional sector, are very low. Unless productivity in this sector increases, there might not be significant improvement in the earning levels.

Though accurate estimates are not available, industrial sickness appears to be widespread in the small-scale sector. It has been estimated that the capacity utilisation in different village and small industries has been ranging from about 45 to 60 per cent. The major problems of the small-scale units are the following :

(i) Problem of inputs: Inadequacy or non-availability of inputs of proper quality at responsible price is important problem facing a number of units. It is pointed out that the allotment of raw materials by State supply corporations have always been inadequate and are hardly enough to work thirty to forty per cent of the installed capacity.[2]

(ii) Financial problems: Many small units face financial crisis. Though there has been an increase in the flow of institutional credit to this sector, large part of this has gone to the relatively large units in this sector. The increased flow of institutional funds in favour of the decentralised industrial sector has not covered the artisan sector adequately which continues to depend, for a major part of its capital requirements, on non-institutional sources, often, at exorbitant rates of interest.

(iii) Marketing problems: Marketing is a major problem area for the small units in general. Small entrepreneurs, generally, do not have resources and expertise to market their products effectively. Financial constraints do not permit them to offer attractive credit terms and the like to the marketing intermediaries. The VSI sector is in a weak bargaining position so much so that the intermediaries take advantage of the situation. Though the governments have taken some steps, marketing arrangements for selling of the products of the small units are still quite inadequate.

(iv) Competition from the large units: Productivity in the VSI sector is, by and large, not satisfactory. No much progress could be made in the upgradation of technology particularly in the traditional sector.

(vii) Institutional constraints: Though a number of measures have been taken by the Central and State Governments to assist the VSI sector, they have not come up to the expectations. The small entrepreneurs have to

---

2. H.K. Rao, "Growth Problems of Small Sector", *The Economic Times*, September 19, 1983.

cross many hurdles to obtain assistance from them. The District Industries Centres (DICs) have not come up to the expectations. There are many criticisms about the functioning of the organisations meant to assist the VSI sector.

In short, as the Planning Commission observes, low levels of technology resulting in poor productivity and inadequate returns continue to characterise the village and small industries. Coupled with this, the problem of obtaining raw materials of desirable quality at reasonable prices and lack of marketing arrangements for selling their produce at fair prices have deprived the artisans of a good part of the earnings which should have accrued to them.

THE NEW POLICY

On August 6, 1991, Government of India announced a new policy for small and tiny enterprises.

The new policy raised the investment limit in plant and machinery for the tiny sector from Rs. 2 lakhs to Rs. 5 lakhs. The investment limit for small scale units is Rs. 60 lakhs and ancillary and export oriented units is Rs. 75 lakhs.

For the first time, the service sector has been identified as tiny sector and its investment would correspond to those of tiny enterprises.

Other important proposals of the new policy are given below.

Financial support measures

Equity participation in small scale units by other industrial undertakings upto 24 per cent of their total shareholding is allowed. This is done to provide small units access to the capital market and encourage modernisation, technical upgradation, ancillarisation and subcontracting.

The policy for the first time promises to meet 100 per cent of credit demand of the small and tiny industries. A monitoring cell was proposed to be created which would remove all hurdles which the government may face to achieve this objective. According to the new policy, emphasis would be shifted from providing cheap credit to adequate flow of credit on a normative basis.

It has been decided to widen the scope of the National Equity Fund Scheme to cover projects upto Rs. 10 lakhs for equity support (upto 15 per cent). It has also been decided to enlarge the single window scheme to cover projects upto Rs. 20 lakhs with a working capital margin upto Rs. 10 lakhs. The composite loans under this scheme would also be channelised through commercial banks, hitherto available only through state financial corporations.

To enhance the supply of risk capital to the SSI sector, a limited partnership Act was proposed to be introduced so as to limit the financial liability of the new and non-active partners/entrepreneurs to the capital invested.

To solve the problem of delayed payments to the small industries sector by the large units, *factoring services* through the Small Industries Development Bank of India (SIDBI) has been introduced and it has been proposed to set up a network of such services throughout the country to be operated through commercial banks. In addition, it has also been proposed to introduce a suitable legislation to ensure prompt payment of small industries bills.

Infrastrucutre,Technology and Inputs

To facilitate location of industries in rural backward areas and to promote stronger linkages between agriculture and industry, a new scheme of integrated infrastructural development (including technological back-up services) for small scale industries would be implemented with the active participation of state governments and financial institutions.

A technology Development Cell (TDC) would be set up in the Small Industries Development Organisation (SIDO), which would provide technology inputs to improve productivity and competitiveness of the products of the small scale sector. The TDC would coordinate the activities of the Tool Rooms, Process-cum Product Developments Centres (PPDCs), existing as well as to be established under SIDO, and would also interact with other industrial research and development organisations to achieve its objectives.

The Policy also proposes to encourage and support industry associations to establish quantity counselling and common testing facilities. Where non-conformity with quality standards involve risk to human life and public health, compulsory quality control is proposed to be enforced.

A reoriented programme of modernisation and technological upgradation aimed at improving productivity, efficiency and cost effectiveness in the small scale sector would be pursued. Specific industries in large concentrations/ clusters would be identified for studies in conjunction with SIDBI and other banks with a view to establishing commercial viability of modernisation prescriptions, and financial support will be provided for modernisation of these industries on a priority basis.

IITs and selected Regional / other Engineering Colleges will serve as Technological Information, Design and Development Centres in their respective command areas.

Government will continue to support first generation entrepreneurs through training and other help. Entrepreneurship Development Programmes (EDP) are also proposed to be built into the curricula of vocational and other degree level courses.

Marketing

The policy envisages that, in addition to the existing support mechanisms, market promotion would be undertaken by cooperatives, public sector institutions and other professional agencies by adopting a consortia approach.

The National Small Industries Corporation (NSIC) would concentrate on marketing of mass consumption items under a common brand name in association with the State Small Industries Development Corporation (SSIDCs).

The Small Industries Development Organisation (SIDO) has been recognised as the nodal agency to support the SSI in export promotion. An export development centre would be set up in SIDO to serve SSIs through its network of field offices to further augment export activities of this sector. A technology development cell would also be set up in SIDO to provide technology inputs for productivity and competitiveness of SSI products.

The tiny sector is to be accorded priority in the government purchase programme.

The new policy proposes a number of measures for the promotion of Khadi and Village Industries, particularly handloom and handicrafts.

The schemes for the handloom sector are proposed to be revised into three major heads:

(a) Project package scheme under which area based approach would be adopted to improve technology and marketing facility.

(b) Welfare package scheme under which the number of welfare schemes would be increased and the funds earmarked for them would be substantially augmented.

(c) Organisation development package under which schemes for participation in the share capital will be re-drawn under organisational development scheme for imparting a better management system.

The Janatha Cloth Scheme which sustains weavers often a minimum level of livelihood will be phased out by the terminal year of the Eight Plan and replaced by the "Omnibus project package scheme" under which substantial funds would be provided for modernisation of looms, training, provision for better designs, provision for better dyes and chemicals and marketing assistance.

The new policy enhances the role of the National Handloom Development Centres (NHDCs). It would now be a nodal agency for increasing supply of bank yarn and of dyes and chemicals. The spinning capacity will also be increased and the National Co-operative Development Corporation (NCDC) will provide more assistance in the form of seed money, both for cotton growers' spinning mills and weavers' spinning mills.

For improving marketing of handloom products, a more intensive implementation of schemes for design and product improvement by national level publicity, exhibitions and design exercises will be undertaken. A special scheme will be drawn up to graduate the handloom production, which is often of low value items, to high value products suitable for export markets. This will be done by better design inputs, upgradation of technology, diversion of weavers from cotton to silk and tassar weaving. Special projects for modernisation of looms for products suitable for export markets will be drawn up.

In the handicrafts sector, emphasis will be given to the following:

(i) Extension of services like supply of raw materials, design and technical guidance, market support, training and procuring of related materials / inputs in an integrated and area based manner through the setting up of craft development centres in identified clusters of villages.

(ii) Market development support in the form of a package of assistance through expansion of marketing infrastructure, exhibitions, publicity etc. through central and state handicrafts corporations, co-operatives and voluntary organisations.

(iii) Measures to sustain an increased exports of handicrafts through new marketing channels like trading companies, departmental stores etc.

Several measures for promoting other village industries have also been proposed. The activities of the KVIC and State Khadi and Village Industries Boards will be expanded and the organisations strengthened to discharge their responsibilities more effectively.

There will be greater emphasis on improving the quality and marketability of the products *pari passu* with consumer preference instead of merely depending on rebates and subsidies.

While plan allocation for rural industries will be augmented, effective steps will also be taken to ensure better flow of credit from the financial institutions and a more coordianated and optimal utilisation of different development schemes and agencies operating in rural areas.

R & D in KVI sector would be strengthened through greater linkages with CSIR and other research institutions in the areas of production, finishing/ packaging, processes and development of new tools and implements. The training programmes would be upgraded and augmented to cover the expanded list of industries under the purview of the KVIC.

Rules and Procedures

The Policy states that the persistent complaint of small scale units of being subjected to a large number of Acts and Laws, being required to maintain a number of registers and submit returns, and face an army of inspectors, would be attended to within a specified time frame of three months.

Procedures would be simplified, bureaucratic controls effectively reduced, unnecessary interference eliminated and paper work cut down to the minimum to enable the entrepreneurs to concentrate on production and marketing functions.

VSI in the VIII Plan

The Eighth Plan aims at a growth rate of 5.6 per cent. The growth rates for the manufacturing sector and exports have been kept 7.3 per cent and 13.6 per cent respectively. While no growth rate has been indicated for the village and small industries sector, it has to be higher than that of the manufacturing sector.

In the new orientation to planning during the Eighth Plan, people's initiative and participation would be a key element in the process of development. Greater emphasis will be laid on private initiative in industrial development. The public sector will become very selective in the coverage of activities and in making investment. Small enterprises in the village and small industries sector are, more or less, based on private initiative and entrepreneurship.

Village and Small Industries — Eighth Five Year Plan (1992-97) — Indicative Targets

S. No. & Industry		*Production*		*EMP. (Lakh Persons)*		*Export (Rs./Crs.)*	
	Unit	*1991-92 Achiev.*	*1996-97 Target*	*1991-92 Achiev.*	*1996-97 Target*	*1991-92 Achiev.*	*1996-97 Target*
Modern Small-Scale Industry							
1. Small-Scale Industries	Rs./Crores	160000	233436	126.00	150.50	12658.00	20200.00
2. Powerloom cloth	Mill.Mts.	11036	15280	53.00	75.00		
Traditional Industries	Rs./Crores	14378	19907				
3. Khadi cloth	Mill.Mts.	114	160.00	14.61	16.50		
	Rs./Crores	278	560				
4. Village Industries	Rs./Crores	2150	3760	35.40	46.25		
5. Handloom cloth	Mill. Mts.	5000	7000	106	117	450.00	1000.00
	Rs./Crores	4064	5690				
6. Securities — Raw Silk	Tonnes	13535	21400	54.50	65.00	600.00	1000.00
	Rs./Crores	996	1590				
7. Handicrafts	Rs./Crores	13260	29620	48.25	77.65	9215.00	27915.00
8. Lakh/tonne	2.2	2.77	5.46	5.84	66.16	100.00	
	Rs./Crores	168	212				
Total (VSI):	Rs./Crores	195294	294775	443.22	553.74	22989.16	50215.00

One of the areas of priority of the Eighth Plan is generation of adequate employment to achieve near full employment level by the turn of this century. Several activities pertaining to this sector like processing of agricultural produce in rural areas, sericulture and allied activities have been identified as critical goals in priority sectors. It is possible to dovetail programmes of khadi, village industries, handlooms, sericulture for selected villages for poverty alleviation through increase in employment. It is also envisaged that entry into the services sector, which is expected to play a major role in generating employment during the Eighth Plan, and the 'informal' sector will be made free of innumerable rules, regulation and bureaucratic controls. Further, research and innovation in the tools and techniques of traditional occupations, including those of rural artisans, will be encouraged and their extensive adaptation will be induced.

New Package

In 1993, the Reserve Bank of India announced a special package of measures to ensure adequate and timely credit to the small-scale sector. The salient features of this package are:

(i) Banks should give preference to village industries, tiny industries and other small-scale units, in that order, while meeting the credit requirement of the small-scale sector;

(ii) Banks should step up the credit flow to meet the legitimate requirements of the SSI sector in full during the Eighth Five Year Plan;

(iii) An effective grievance redressal machinery within each back which can be approached by the SSI in case of difficulties would be set up; and

(iv) Banks should adopt the single window clearance scheme of SIDBI for meeting the credit requirements of small-scale units.

To ensure prompt payment to small-scale units the Parliament enacted the Interest on the Delayed Payments Act, 1993.

Various procedural simplifications including new registration forms have also been introduced.

16

Industrial Sickness

Industrial Sickness is a universal phenomenon. While the industrial sickness is easily manifested in economies characterised by the existence of the market mechanism, it may be concealed in the economies where the market mechanism does not operate. In a market economy, the competition tests and exposes the strengths and weaknesses of the business enterprises and therefore sickness becomes easily visible.

There has been an increase in industrial sickness, both in the large and small sectors, in India. By consoling that this is, to some extent, a corollary of industrial growth, one shall not belittle the seriousness of the problem. Industrial sickness affects not only the owners, employees and creditors but also causes wastage of national resources and social unrest. It is, therefore, considered very much essential to devise suitable measures for dealing with sick units as well as to make suitable arrangements for detecting symptoms of industrial sickness at an early stage so as to take measures to prevent sickness.

Definition of Sick Unit

There are different perceptions of the symptoms and characteristics of industrial sickness. Sickness is a relative concept. Further, "a given sickness manifests itself in several forms, and at a point of time these forms may not throw unambiguous or clear-cut signals. No wonder, then, that sickness is found being understood, interpreted and measured differently be individuals and even by institutions".[1]

"To a layman, a sick unit is one which is not healthy. To an investor, it is one which skips dividends. To an industrialist, it is a unit which is making losses and tottering on the brink of closure. To a banker, it is a unit which has incurred cash losses in the previous year and is likely to repeat the performance in the current and following years."[2] In terms of the definition evolved by the Reserve Bank of India, *an industrial unit is regarded as sick if it has incurred cash loss for one year and in the judgement of the bank, it is likely*

---

1. J.C.Sandesara, "Industrial Sickness in India", *The Economic Times*, March 6, 1987 p-44.
2. V.N. Nadkarni, "Sickness in Industry and its Effect on Banking," *State Bank of India Monthly Review*, June 1983, pp. 245-46.

to continue to incur cash loss in the two following years and it has imbalance in its financial structure such as current ratio being less than 1:1 and worsening debt equity ratio. The sick Industrial Companies (Special Provisions) Act, 1985, as amended in 1993 defines a sick industrial company *as an industrial company (being a company registered for not less than five years) which has at the end of any financial year accumulated losses equal to or exceeding its entire networth.* The definition is for the purpose of application of the Act and it covers only registered companies which have been existence for at least five years.

Common symptoms of industrial sickness include failure to pay statutory liabilities like Provident Fund and E.S.I. contributions, failure to pay timely instalment of capital and interest on loans taken from financial institutions and through public deposits, increase in inventories with a large number of slow or non-moving items, high rate of rejection of goods manufactured, low capacity utilisation and frequent industrial disputes.

Magnitude

The number of sick units has grown considerably from 22,366 at the beginning of 1980 to 2.48 lakh at the end of March 1992 and the total bank credit blocked up in these units increased from Rs. 1,809 crores to Rs. 11533.3 crores during this period. 99 per cent of the sick units were in the small-scale sector. The above figures included 876 non-SSI weak units.

Data for the recent years show that, in the large-scale sector, the incidence of sickness was high in industries like engineering, cotton textiles, jute textiles and sugar. It was also revealed that the industrially advanced states accounted for a major share of the large sick units.

Viability studies have revealed that nearly 90 per cent of the sick units were non-viable. Only about 12 per cent of the total number of the sick units were considered potentially viable and these units accounted for nearly 45 per cent of the total bank credit enjoyed by the sick units. Over 86 per cent of the total number of the sick units, accounting for nearly 50 per cent of the bank credit to the sick units were considered as non-viable. The viability of the remaining units, (1.56 per cent of the total number) were not decided.

Weak Units

According to the Sick Industrial Companies (Special Provisions) Act, an industrial unit is regarded as sick only if it has, at the end of any financial year, accumulated losses equal to or exceeding its entire networth. It is, however, important to detect sickness at the incipient stage and take necessary remedial measures. The Reserve Bank has, therefore, advised the commercial banks to take remedial measures in respects units at the stage of 50 per cent erosion of their networth. Such units are termed as weak units to distinguish them from sick industrial companies as defined in the Sick Industrial Companies Act. An industrial unit is termed as weak if at the end of any accounting year it has:

---

* At the end of March 1991, there were 127575 non-existent/non-traceable SSI units with an outstanding bank credit of Rs. 284 crores.

(i) accumulated losses equal to or exceeding 50 per cent of its peak networth in the immediately preceding five accounting years;

(ii) a current debt-equity ratio of less than 1:1; and

(iii) suffers a cash loss in the immediately preceding accounting year.

Causes of Sickness

Industrial units may become sick at different stages and due to different reasons. Indeed, "some industries are born sick, some achieve sickness and some have sickness thrust upon them".[3]

(i) Born Sick: Industries born sick are those which are destined for disaster right from their conception due to various causes. A study conducted by the Institute of Economics, Hyderabad, found that 50 per cent of the dead units closed within three years of opening. This proves that these industries never had any reasonable survival prospect right from birth.[4]

Any one or more of the following factors may cause the birth of sick units:

1. Lack of experience of the promoters, wrong selection of the project, faulty project planning, etc., may give birth to sick units. The mushroom growth of the so-called consultancy firms has been regarded as a factor contributing to these sorts of problems because the primary interest of such consultancy firms is to make money by selling some ideas or project reports to the aspirants who may thus be misguided or made overenthusiastic. We must also think that the rosy hopes generated by the high-sounding promises and schemes including the self-employment schemes of the financial institutions and other promotional agencies of the Governments also contribute to this unfortunate situation.

2. Paucity of funds and faulty financial management may also cause the birth of sick units. Many new units have been found to be under-utilised and the strains of undercapitalisation. become evident when the unit becomes operational. In case of some companies, the heavy investment in non-productive capital assets like staff housing projects even before they commence production distorts the liquidity and causes a lot of problems. Problems also crop up due to inadequate provisions for contingencies, faulty fund flow and cash flow estimate, etc.

---

[3] *Ibid.*, p. 246.

[4] *Ibid.*, p 247.

3. Time and cost over-runs sometimes prove to be very disastrous. Particularly in case of large projects, delays in project commissioning due to delay in supply of equipment, both indigenous and imported, slippage in the schedule of civil works, creation of equipment, etc., are not uncommon. Such delays cause cost escalations leading to capital shortage, liquidity problems, hike in the production costs and break-even point etc.

4. Sickness may arise from locational problems also. It has been observed that "high-technology based units are established in areas without skilled labour or supporting infrastructure; industries based on imported raw materials are founded in regions without adequate transport and communication system".[5]

5. Technological factors like selection of obsolete or improper technology or the technology becoming outdated due to innovations while the project is being executed, sub-standard machinery, wrong collaboration, etc., also cause sickness.

According to the Tiwari Committee, 14 per cent of the large sick units suffered from technical factors and faulty initial planning.

6. Wrong assessment of the market potential or faulty demand forecasting, change in the market conditions, including the change in the consumer tastes and preferences and competitive situation, etc. can also cause birth of sick units.

(ii) Achieved Sickness: Industries which achieve sickness are those which fail after becoming operational due to internal causes. Such internal causes which are common are the following:

1. Bad management, which "covers a wide range from inexperience, inefficiency, lack of professional expertise, neglect and internal squabbles to delinquency and dishonesty"[6] is an important cause of industrial sickness. According to the Tiwari Committee Report, 1984, "the factor most often responsible for industrial sickness can be identified as 'management'. This may take the form of poor production management, poor labour management, poor resources management, lack of professionalism, dissensions within the management, or even dishonest management". The Committee found that 65 per cent of the large sick units were affected by this problem.

2. Unwarranted expansion and diversion of resources may also result in sickness. Some concerns tend to expand beyond the resources including managerial capability. Diversion of resources to start new units or to acquire interest in other concerns without due regard to the capability of the unit to provide such funds sometimes lands the unit in trouble.

---

[5] *Ibid.*, p. 247.

[6] *Ibid.*, p. 247.

Personal extravagances and acquisition of unproductive fixed assets like company guest houses or corporate luxuries like air-conditioned cars, etc., also may contribute to sickness.

3. Poor inventory management in respect of finished goods as well as inputs may land a unit in trouble.

4. Failure to modernise, the productive apparatus, change the product mix and other elements of the marketing mix to suit the changing environment is a very important cause of industrial sickness.

5. Poor labour-management relationship and the associated poor worker morale and low productivity, strikes, lockouts, etc., also may ruin the health of a unit to survive.

(iii) External Causes: Sickness may be caused also due to factors beyond the control of an industrial unit. Some of these common external factors are the following:

1. Energy crisis arising out of power cuts or shortage of coal, and oil have almost become a constant problem for many industrial units in India.

2. In a number of cases the units are not able to achieve optimum capacity due to shortage of raw materials due to production set-backs in the supply industries, poor agricultural output due to natural reasons, changes in the import conditions etc.

3. Infrastructural problems like transport bottlenecks also sometimes cause serious problems.

4. It is a general complaint of the industrial circles that the credit squeeze very adversely affects the industrial sector. According to the Tiwari Committee, 24 per cent of the large sick units were affected by shortage of working capital/liquidity constraints.

5. Artificial economic constraints also make their contribution to the growing industrial sickness. Government controls on the product mix and prices are said to be causing serious problems for certain industries. Sometimes, it is not possible to automate or rationalise due to unfavourable government policy or labour attitude.

GOVERNMENT POLICY

There has been strong demand for take-over of sick units by the Government, particularly to protect the employment. However, a relevant question to be considered here is the opportunity cost of the government decision. Should the government utilise the scarce resources to create new productive employment or should they be spent on maintaining some jobs at heavy social costs? Further, it is also necessary to guard against the managements, 'looking forward' to the government take-over of an undertaking after fleecing and mismanaging it to the point of making it permanently sick.

However, in an economy where the government has assumed strong regulatory and promotional roles, it should take necessary steps to prevent sickness and to help cure incipient sickness.

The Companies Act, 1956, empowers the government to collect information from the companies which would enable it to assess the state of affairs of the companies and to take certain measures to prevent mismanagement. The Industries (Development and Regulation) Act, 1951 (IDRA), empowers the government to regulate the management of industrial undertakings, including the take-over of the management or the undertaking. The Sick Industrial Companies (Special Provisions) Act, 1985, is a very important law to deal with industrial sickness.

In 1981, the government announced certain policy guidelines to deal with industrial sickness. These guidelines require the ministries administratively concerned with various industries to take responsibility for rehabilitation of sick units. Banks and financial institutions are required to strengthen the monitoring arrangement for prevention of sickness.

Indeed, both Government and financial institutions have been concerned at the problem of growing sickness, and attempts have been made to devise suitable measures to tackle it. The approach followed has been to nurse sick units which are potentially viable back to health through a managed programme of financial assistance for modernisation and recovery. The Reserve Bank took the initiative in the matter of identifying sick industrial units, and coordinating the lending operations of the term lending institutions and commercial banks.

An important limitation on the ability to tackle sickness arise from the fact that commercial banks may legitimately consider sick units as poor security risks.

Government policy towards the prevention and treatment of industrial sickness is guided by the following considerations:

On the preventive side, it is considered that closer and more vigilant involvement of the financial institutions in the units with management of doubtful competence or integrity is essential. Financial institutions have jointly set up a group of professional directors who are full-time employees of the institutions and who could be nominated on the Board of Directors of companies with doubtful management and in which the institutions have a substantial stake. These directors report to the institutions on the measures that should be taken to prevent sickness. If any such director comes across features of a company's operation which give cause to suspect malpractice or gross incompetence, he would report to the financial institutions for further investigation. The concerned institution will then report the matter to an inter-institutional group under the Chairmanship of Industrial Development Bank of India. If this group comes to the conclusion that the management has acted in a patently incompetent manner or has indulged in malpractice, all the institutions and the commercial banks should take a decision that this unit or any other unit under the same management will not be extended financial assistance until the management is changed.

The rehabilitation scheme for a sick unit will depend on the extent of sickness of the unit, its future prospects and the management. Financial institutions have realised that the usual methods of rehabilitation are not quite adequate for acute cases of sickness. Such cases may require extraordinary efforts and measures including leasing out an undertaking, merger and amalgamation, restructure of capital and liabilities, selling a unit on block basis, etc. In such cases, the cooperation of all concerned agencies is of utmost importance and invariably workers are called upon to extent greater co-operation. It has been agreed that the lead financial institution and the lead bank will jointly ensure that a scheme is prepared within a time limit of 90 days as fixed under the Sick Industrial Companies (Special Provisions) Act. Some of the State Governments have also started taking preventive measures by announcing certain reliefs and concessions in advance even for units which do not attract the definition of industrial sickness.

The Government has recently specified the economic size of units in many industries. This measures is expected to help check sickness arising out of uneconomic size of industrial units.

The RBI has been closely monitoring certain specific industries where the incidence of sicknes is high. Standing Committees have been set up in the RBI for the jute and sugar industries to consider the specific problems of these sectors.

Another significant policy initiative has been the introduction of liberalised margin money scheme for supplementing the efforts of the State Governments in reducing sickness in the small-scale sector in June 1987. Under this scheme, the State Governments are to make a matching contribution on a 50:50 basis in providing assistance to sick small-scale units in their rehabilitation. In the revised scheme, the maximum quantum of assistance has been enhanced from Rs.20,000 to Rs.50,000 per unit.

IDRA

The Industries (Development and Regulation) Act, 1951, empowers the Central Government to take over an undertaking or its management in certain cases.

In the case of industrial units that are already sick the following options will first be explored before the question of the take-over of management under the Industries (Development and Regulation) Act is considered:

(i) Rehabilitation through State Governments and financial institutions who would provide both financial and managerial support with suitable restructuring of management wherever necessary. In cases where co-ordinated action is necessary for the revival of the unit outside the framework of the Industries (Development and Regulations) Act, the concerned Administrative Ministry will take the initiative to co-ordinate the arrangements.

(ii) Proposals, if any, for the merger of the sick unit with a healthy unit in the private sector will be examined by the Specified Authority under the Income -Tax Act, 1961, with reference to the guidelines on the subject.

It is only where neither of the above alternative course of action is feasible or desirable that action under the Industries (Development and Regulation) Act would be considered.

In the past, the Government took over, selectively, the management of a number of sick industrial undertakings under the IDRA. For example, a large number of sick textile mills were taken over and brought under the National Textiles Corporation (NTC). The objective was to revive these units by providing management support and financial assistance through banks and other financial institutions. While some units were nursed back to health, a number of others continued to suffer huge losses.

The Government do not now favour takeover of sick units.

Now the approach of the government towards rehabilitation of a sick unit is very selective because the government is convinced that there is no point in throwing away further resources in support of the units which are irretrievably sick. Only such units which are found to be potentially viable need to be taken up for formulation of rehabilitation packages to restore them to health. The package consists of concessions from banks, financial institutions, government (Central/State), government agencies, shareholders, labour, suppliers of goods as viable it if would be in a position, after implementing a package of concessions spread over a period not exceeding seven years from the commencement of the package, to continue to service its repayment obligations, as agreed upon, including those forming part of the package, without the help of any further concessions after the aforesaid period. The repayment period for restructured debts should not exceed 10 years from the date of implementation of the package.

SICK INDUSTRIAL COMPANIES ACT

The most important piece of legislation dealing with industrial sickness is the Sick Industrial Companies (Special Provisions) Act, 1985.

Objectives

The objectives of the Sick Industrial Companies (Special Provisions) Act, 1985 (SICA), are:

(i) the timely detection of sick and potentially sick companies owning industrial undertaking;

(ii) the speedy determination by a Board of experts of the preventive, ameliorative, remedial and other measures which need to be taken with respect to such companies; and

(iii) the expeditions enforcement of the measures so determined and for matters connected therewith or incidental thereto.

Application of the Act

This Act which extends to the whole of India applies to all the scheduled industries (i.e., industries specified in the First Schedule to the Industries (Development and Regulation) Act, 1951) other than the scheduled industry relating to ships and other vessels drawn by power. However the Central Government may, in consultation with the RBI, apply this Act to the scheduled industry relating to ships and other vessels drawn by power.

Ancillary and small scale undertakings are excluded from the application of this Act.

Sick and Potentially Sick Companies

According to the SICA, a sick industrial company means *an industrial company (being a company registered for not less than five years) which has at the end of any financial year accumulated losses equal to or exceeding its entire networth.*[7]

An industrial company is regarded as potentially sick, *if the accumulated losses*[8] *of an industrial company as at the end of any financial year have resulted*

---

[7] Before the Sick Industrial Companies (Special Provisions) Amendment Act, 1993, the definition was "as industrial company (being a company registered for not less than *seven* years) which has at the end of any financial year accumulated losses equal to or exceeding its entire networth *and has also suffered cash losses in such financial year and the financial year immediately preceding such financial year.*

[8] *Cash loss* means loss as computed without providing for depreciation.

in the erosion of fifty per cent or more of its peak networth[9] *during the immediately preceding four*[10] *financial years.*

BIFR and AAIFR

The SICA provides for the establishment by the Central Government of a Board for Industrial and Financial Reconstruction (BIFR) to exercise the jurisdiction and powers and discharge the functions and duties conferred or imposed on the Board by the Act.

The Board shall consist of a Chairman and not less than *two* and not more than *fourteen other* members (having the qualifications specified under this Act) appointed by the Central Government.

The Act also provides for the establishment of an appellate authority called the Appellate Authority for Industrial and Financial Reconstruction consisting of a Chairman and *not more than three other* members (having the qualifications prescribed in the Act) for hearing appeals against the orders of the BIFR.

The jurisdiction, powers and authority of the Board or the Appellate Authority may be exercised by *Benches* there of constituted by the chairman. Each Bench shall consist of *not less two* members.

The Board and the Appellate Authority have the same powers as are vested in a civil court under the Code of Civil Procedures.

References, Inquiries and Schemes

Under section 15 of the Act, the Board of Directors of a sick industrial company shall make a reference to the BIFR for determination of the measures to be adopted with respect to the company. Such a reference shall be made within sixty days form the date of finalisation of the duly audited accounts of the company for the financial year at the end of which the company has become a sick industrial company. However, if the Board of Directors has sufficient information even before the finalisation of the account that the company had become sick, it shall make a reference to the BIFR within sixty days such information.

A reference of industrial sickness may be made to the BIFR also by the Central Government, the RBI, the Government of a State in which any of the industrial undertaking of the sick company is located or a financial institution or bank which has a stake in the sick company.

---

[9] *Networth* is the sum total of the paid-up capital and free reserves — *Free reserves* means all reserves credited out of the profits and share premium account but does not include reserves credited out of revaluation of assets, write back of depreciation provisions and amalgamations.

[10] Before the Amendment of 1933, it was preceding *five* financial years.

Upon receipt of a reference or upon its own knowledge as to the financial condition of the company, the BIFR may make an inquiry either directly or by an operating agency (a financial institution or scheduled bank) for determining whether any industrial company has become sick. Endeavour shall be made to complete the inquiry within sixty days from the commencement of the inquiry. The 1993 Amendment to the Act lays down that an inquiry shall be deemed to have commenced upon receipt by the Board of any reference or information or upon its own knowledge reduced to writing by the Board.

Where the BIFR deems it fit to make such an inquiry as mentioned above, it may appoint one or more persons to be a special director/directors of the company for safeguarding the financial and other interests of the company or in the public interest.

If, after the inquiry, the BIFR is satisfied that the company has become sick, it shall, after considering all the relevant facts and circumstances of the case, decide, as soon as may be, whether it is practicable for the company to make its networth exceed the accumulated losses within a reasonable time and it is practicable the Board shall, subject to such restrictions or conditions as may be specified, give such time to the company as it may deem fit to make its networth exceed the accumulated losses.

If the BIFR decides that it is not practicable for the sick company to make its networth exceed the accumulated losses within a reasonable time and that it is necessary or expedient in the public interest to adopt certain measures for improving the performance of the company, the Board may direct any operating agency to prepare a scheme providing for such measures. The Board may direct any operating agency to prepare such a scheme also in respect of a sick industrial company which was allowed time to make its networth exceed the accumulated losses but which has failed to comply with any of the conditions or restrictions specified in this respect or has failed to revive as stipulated.

The operating agency shall prepare the scheme as expeditiously as possible and ordinarily within a period of ninety days. The scheme may provide for any one or more of the following measures:

(i) The financial reconstruction of the company.

(ii) The proper management of the sick industrial company by changing or takeover of, management of the sick industrial company.

(iii) The amalgamation of —

  (a) the sick industrial company with any other company, or

  (b) any other company with the sick industrial company.

(iv) The sale or lease of a part or whole of industrial undertaking of the sick industrial company.

(v) The rationalisation of managerial personnel, supervisory staff and workmen in accordance with law.

(vi) Such other preventive, ameliorative and remedial measures as may be appropriate.

(vii) Such incidental, consequential or supplemental measures as may be necessary or expedient in connection with or for the purposes of the measures mentioned above [(i) to (vi)]

Where the scheme relates to preventive, ameliorative, remedial or other measures with respect to any sick industrial company, the scheme may provide for financial assistance by way of loans, advances, or guarantees or reliefs or concessions or sacrifies from the Central Government, State Government, financial institutions, banks or any other institution or authority to the sick industrial company. Where in respect of any such scheme the consent is given by every person required, to provide financial assistance, the BIFR may, as soon as may be, sanction the scheme and from the date of such sanction the scheme shall be binding on all concerned.

If the consent is not given by any such person required by the scheme to provide financial assistance, the Board may adopt such other measures, including the winding up of the company, as it may deem fit.

Winding-up of Sick Company

Where the BIFR, after making the inquiry and after consideration of all relevant facts and circumstances and after giving an opportunity of being heard to all concerned parties, is of the opinion that the sick industrial company is not likely to make its networth exceed its accumulated losses within a reasonable time and that it is not likely to become viable in future and that it is just and equitable that the company should be wound up, it may record and forward its opinion to the High Court. The High Court shall order the winding up of the company and may proceed and cause to proceed with the winding up of the sick industrial company in accordance with the provisions of the Companies Act, 1956.

Proceedings in Case of Potentially Sick Companies

The SICA seeks to detect potentially sick industrial companies and prevent them from becoming sick.

If the accumulated losses of an industrial company, as at the end of any financial year, have resulted in the erosion of fifty per cent or more of its peak networth during the immediately preceding four financial years, within sixty days from the date of finalisation of the duly audited accounts for that year, the Board of Directors shall

(i) report the fact of such erosion to the BIFR; and

(ii) hold a general meeting of the shareholders of the company for considering such erosion and by an ordinary resolution passed at this meeting the company may remove a director (being a director appointed by the members of the company). The vacancy created by such removal may be filled, so far as may be, in accordance with the procedure provided in sub-section (2) to (b) of section 284 of the Companies Act, 1956.[11]

As in the case of the sick companies, a reference about the erosion fifty per cent or more of the net-worth may be made to the BIFR by the Central Government, State Government concerned, RBI, a financial institutions or a scheduled bank.

Where the BIFR is of the opinion that the industrial company is not likely to make its net-worth exceed its accumulated losses within a reasonable time, while meeting its financial obligations, and that the company is not likely to become viable in future it may require an operating agency to inquire into and make a report with respect to such matters as may be specified.

After consideration of the report of the operating agency, the Board may publish a notice for suggestions and objections, if any, as to why the company should not be wound up.

After consideration of the relevant facts and circumstances and after giving an opportunity of being heard to all concerned parties, if the Board is of the opinion that the industrial company is not likely to make its net-worth exceed the accumulated losses within a reasonable time and that it is unlikely to become viable in future and that it is just and equitable that the company should be wound up, the Board may record and forward its opinion to the High Court. The High Court shall order the winding up of the company and may proceed and cause to proceed with the winding up of the company in accordance with the provisions of the Companies Act, 1956.

Misfeasance Proceedings

If it appears to the BIFR that any person who has taken part in the promotion, formation of management of the sick industrial company or its undertaking, including any past or present director, manager, or officer or employee, has misappropriated money or property or has been guilty of any misfeasance, malfeasance or non-feasance or breach of trust in relation to the sick industrial company, the Board may order him to repay or restore the money or property.

---

[11] These sub-sections lay down that special notice shall be required of any resolution to remove a director or to appoint somebody instead of a director so removed at the meeting at which he is removed and that the vacancy created by such removal may be filled by the appoint of another director by the same meeting at which the director is removed. If the vacancy is not filled by this meeting, it may be filled as a casual vacancy by the Board of Directors, but the person who was removed shall not be reappointed.

The BIFR may also direct financial institutions and scheduled banks not to provide any financial assistance, during the period of the next 10 years, to such persons who have misappropriated the funds or property of the company.

Appeal

Any person aggrieved by an order of the BIFR may prefer an appeal to the Appellate Authority for Industrial and Financial Reconstruction.

A REVIEW OF THE BIFR

A major drawback of the BIFR has been the long delay in dealing with industrial sickness. The time taken for various procedures under the SICA has, however, been considerably reduced now. The average time taken between the registration of a case and its first hearing was 160 days during the first five years; it was only 63 days in 1994. The average time taken for deciding a case was nearly two years in the first 5 years. It was reduced to about six months in 1993 and 52 days during 1995.

Several of the cases registered in 1988, 1989 and 1990 were still pending in the early 1995.

Since the inception up to the end of December 1995, the BIFR received 2497 references under Section 15 of the SICA. Of these, 1756 references were registered for further action under the provisions of the Act. Of the 1756 references, 354 were dismissed as not maintainable, revival schemes were sanctioned or approved in respect of 530 cases and 407 cases were recommended to the High Courts for winding up under the provisions of the Companies Act. 10 cases were dropped as the networth of the company became positive during the course of the inquiry.

A recent study of the revival schemes under implementation reveals that about 22 per cent of the cases are on the road to revival, in about 20 per cent of the cases it is too early to form an opinion and the progress is not satisfactory in the remaining 36 per cent.

In order to establish a system of rehabilitation and restructuring of PSUs without having Government to bear the whole financial burden, certain provisions of the Sick Industrial Companies Act were amended to bring public sector undertakings (PSUs) under its purview. Till the end of December 1995, 59 Central PSUs were registered with BIFR and orders were already issued by the Board for revival of units like I.D.P.L. and Biecco Lawrie Ltd. 79 state

PSUs were also registered with the BIFR. It has also recommended the winding up of several PSUs (Bicycle Corporation of India Ltd., Cawnpore Textiles Ltd., Elgin Mills Ltd., and British India Corporation Ltd.).

Delay in the disposal of cases of PSUs has been, inter alia, to inadequate information furnished by PSUs, non-availability of final views of the Central/State Governments, and the complexity of the cases.

FINANCIAL INSTITUTIONS AND INDUSTRIAL SICKNESS

Financial institutions have to play a very important role in the prevention of sickness and rehabilitation of potentially viable sick units.

In view of the fact that large amount of bank credit was blocked up in the sick units, the Reserve Bank had issued, in 1976, guidelines to the commercial banks so as to identify incipient sickness. The RBI had also set up a *sick units cell*. The cell serves as a reference point and tries to bring about co-ordination in the efforts of banks, financial institutions and Government in solving the problems of sick units and issues suitable instructions and guidelines to banks as and when necessary.

The steps initiated by the commercial banks and other financial institutions and the Government under the Sick Industrial Companies (Special Provisions) Act are helping in timely detection of sickness. From time to time, industrial studies have been conducted by the financial institutions where it has been found that sickness is afflicting the industrial growth and climate. Inter-Institutional Rehabilitation Meetings (IIRMs) are periodically held under the auspices of Industrial Reconstruction Bank of India (IRBI) were sick cases are discussed in detail and detail rehabilitation packages drawn up, in addition to various policy issues relating to rehabilitation of sick industrial units.

As modernisation is one of the important measures to prevent sickness, financial institutions are extending soft loans for modernisation of industrial units, in 1986 the IDBI established the Textile Modernisation Fund and the IFCI established the Jute Modernisation Fund. Further, in the same year, the IDBI created the Small Industries Development Fund (SIDF).

In 1971, the Central Government established the Industrial Reconstruction Corporation of India (IRCI) with the specific objective of dealing with the problem of industrial sickness. The IRCI ceased to exist when the Industrial Reconstruction Bank of India (IRBI) was established in 1985. The assets and liabilities of the IRCI were taken over by the IRBI, which has been given statutory status so as to effectively discharge its function.

It is reported that as a result of the efforts taken by the IRBI towards prevention of industrial sickness, industrial undertakings are now approaching the IRBI for their cases at the incipient stage of sickness and that they have become aware of the need to correct the imbalances of long-term and short term funds, replacement of balancing equipment and modernisation of obsolete and old plant and machinery at an early stage so that the cases of rehabilitation vis-a-vis their financial involvement to set right their industrial activities become less. In addition, the companies are also approaching IRBI for financial assistance for expansion, diversification, modernisation etc. For further information on IRBI, see chapter 29.

SICK SMALL-SCALE UNITS

The number of sick units in the small-scale sector has increased substantially. According to the RBI data, the number has increased from 23,149 involving a bank credit of Rs. 305.77 crores at the end of December 1980 to 2.45 lakhs involving a bank credit of Rs. 3100.67 crores at the end of March 1992. Nearly 8 per cent of the total number of small-scale units enjoying bank credit were found to be sick. The sick small-scale units accounted for more than 16 per cent of the bank credit to the small-scale units.

Reflecting the serious concern over the growing sickness in the small-scale sector, in February 1987 the Reserve Bank issued to all scheduled commercial banks guidelines for rehabilitation of small-scale units. The separate guidelines regarding sick small-scale units have been issued because, although sickness in the large, medium and small industrial units exhibit many common features, any approach to sickness in SSI sector has to reckon with the relative weakness of such units to withstand difficulties as also the distinction between the small-scale units and tiny sector units and units in the decentralised sector comprising artisans, village and cottage industries units. It has, therefore, been felt that the emphasis of the rehabilitation effort in the case of SSI units should be on adequate and intensive relief measures and their speedy application rather than giving a long span of time to the units for rehabilitation.

According to the definition adopted by the guidelines, *a SSI unit should be considered sick if it has (a) incurred cash loss in the previous accounting year and is likely to continue to incur cash loss in the current accounting year and had an erosion on acount of cumulative cash losses to the extent of 50 per cent or more of its networth and/or (b) continuously defaulted in meeting four consecutive quarterly instalments of interest or two half-yearly instalments of principal of term loans and there are persistent irregularities in the operations of its credit limits with the bank. While both the conditions (a) and (b) should be satisfied in the case of large SSI units, it would suffice if either alternative (a) or (b) is satisfied in the case of the tiny and decentralised sector units.*

The guidelines point out that it is of utmost importance to take measures to ensure that sickness is arrested at the incipient stage itself and the management of the units financed should be advised about their primary responsibility to inform the banks if they face problems which could lead to sickness and to restore the units to normal health. The bank branch officials, who are in constant contact with them, should develop mutual confidence between the bank and the borrowers. The organisational arrangements at the branch level should also be fully geared for early detection of sickness and prompt remedial action. Bank/Financial institutions will have to identify the units showing symptoms of sickness by effective monitoring. The Guidelines give an illustrative list of warning signals of incipient sickness related to periodical financial data, stock statements, reports on inspection of factory premises and godowns etc. which serve as a useful guide to the operating personnel. (See *Appendix 16.1*). The branch officials who are familiar with the day-to-day operations in the borrowal accounts should be under obligation to identify the early warning signals and initiate corrective steps promptly. Such steps may include providing timely financial assistance depending on established need, if it is within the power of the branch manager, and an early reference to the controlling office where the reliefs required are beyond his delegated powers. The branch manager should also help the unit in sorting out difficulties which are non-financial in nature and require assistance from outside agencies like Government departments/ undertaking, Electricity Board etc. He should also keep the term lending institutions informed about the position of the units wherever they are also involved.

The Guidelines emphasise that only those units which are considered as potentially viable be taken up for rehabilitation. According to the Guidelines, a unit may be regarded as potentially viable if it would be in a position, after implementing a relief package spread over a period not exceeding 5 years from the commencement of the package from the banks, financial institutions, Government (Central/State) and other concerned agencies, as may be necessary to continue to service its repayment obligations as agreed upon including those forming part of the package. In the case of tiny/decentralised sector units, the period of reliefs/concessions and repayment period of restructured debts will be 2 years and 3 years respectively.

The norms, prescribed by the Guidelines, for grant of reliefs and concessions by banks/financial institutions to potentially viable sick SSI units for rehabilitation are reproduced in *Appendix 16.2*.

LOC

The Industrial Reconstruction Bank of India (IRBI) introduced a Line of Credit (LOC) Scheme for the small-scale sector. Under this Scheme funds are given to State level institutions designated by the State Governments at a lower rate of interest.

SIDF

In May 1986, the IDBI created a Small Industries Development Fund to provide assistance for development, expansion, diversification, modernisation and rehabilitation of small-scale, cottage and village industries and tiny sector units.

National Equity Fund

Another important step was the establishment of the National Equity Fund in 1986-87, with a contribution of Rs. 5 crores each by the Central Government and the IDBI. Under this scheme, administered by the IDBI and operated through nationalised banks, assistance will be provided by way of seed capital, in the form of soft loans to eligible small and tiny units with the project cost not exceeding 5 lakhs and located in villages or towns with population not exceeding 5 lakhs. New units, as also the potentially viable sick units in the small-scale sector, eligible for assistance under the Refinance Scheme of IDBI, will get support out of the Fund. Assistance under the scheme is available upto a maximum of Rs. 75,000 per project at a nominal service charge of 1 per cent per annum. The units availing this assistance are required to mobilise cash contribution of 10 per cent of the project cost.

TURNAROUND MANAGEMENT

The term turnaround management refers to the management measures which reverse the negative trends in the performance indicators of an industrial unit. In other words, turnaround management refers to the management measures which turn a sick unit back to a healthy one or those measures which reverse the deteriorating trends of the performance indicators such as falling market share, sales (in constant rupees), and profitability and worsening debt-equity ratio.

Turnaround Management Factors

The exact nature of trunaround management and the relative importance of different factors may vary from company to company. The important factors commonly employed in turnaround management are the following. The following account is based on this author's examination of several successful cases of turnaround management.

(i) Management Factor

Managerial inefficiency is the root cause of the problems in a number of cases. Therefore, improvement of the management, a new efficient chief executive officer is usually appointed. The new CEO should streamline things and in many cases will have to change the organisational culture. This was true of several successful cases of turnaround management such as E.I.D. Parry and Travancore Cochin Chemicals Ltd. (TCC).

(ii) Human Resource Factor

In many of the companies which are in a very bad shape, the human resource is redundant, demoralised and surplus. The surplus manpower should be got rid of, morale should be restored, quality of the manpower should be improved through training and recruitment of competent people for the key positions, if need be.

(iii) Production Facilities

Modernisation and other improvements of plant, equipments etc. are also often an important part of the turnaround management. Such measures help to achieve uninterrupted production flow and better capacity utilisation, quality improvement, reduction. Proper management of the plant and equipments like preventive maintenance etc. have also been found to be absent in several sick units.

(iv) Finance Management

Arranging additional finance, financial discipline, financial restructuring etc. are usually an inevitable part of the turnaround management.

(v) Product Mix Modification

A number of turnaround management cases involve modification of the product mix. Unprofitable products may have to be dropped and new products may have to be introduced. Sometimes current products require quality improvement or some other modification. In some cases new models may have to be introduced.

(vi) Marketing Strategy

Absence of a proper marketing strategy is a major reason for the problems of several companies. An appropriate marketing strategy could help improve such cases. Even product mix modification may form a part of such a strategy. Marketing strategy may also involve market modification like entering new markets or market segments, withdrawing from certain markets/segments, developing new customers etc.

(vii) Miscellaneous

Turnaround management may also involve several other measures like liquidation of assets which are not in use, closing down of some divisions or lines of business, restraints on emoluments of employees, better management of procurement of raw materials, etc.

Elements in Turnaround Management

From case studies of turnaround management of ten companies, Khandwalla has identified the following ten elements of a successful turnaround strategy.[8]

---

[8] Pradip N. Khandwalla, "10 Elements in Turnarounds," *Business World*, June 7-20, 1989, pp. 18-19.

(i) Change in the top management

(ii) Initial credibility building actions

(iii) Neutralising external pressures

(iv) Initial control

(v) Identifying quick payoff activities

(vi) Quick cost reductions

(vii) Revenue generation

(viii) Asset liquidation for the generating cash

(ix) Mobilisation of the organisation

(x) Better internal coordination

APPENDIX 16.1

Illustrative list of warning signals of incipient sickness that are thrown up during the scrutiny of borrowal accounts and other related records (e.g., periodical financial data, stock statements, report on inspection of factory premises and godowns etc.)

(a) Continuous irregularities in cash credit/overdraft/accounts such as inability to maintain stipulated magin on continuous basis or drawings frequently exceeding sanctioned limits; periodical interest debited remaining unrealised.

(b) Outstanding balance in cash credit account remaining continuously at the maximum.

(c) Failure to make timely payment of instalments of principal and interest on terms loans.

(d) Complaints from suppliers of raw materials, water, power etc. about non-payment of bills.

(e) Non-submission or undue delay in submission or submission of incorrect stock statements and other control statements.

(f) Attempts to divert sale proceeds through accounts with other banks.

(g) Downward trend in credit submissions.

(h) Frequent return of cheques or bills.

(i) Steep decline in production figures.

(j) *Downward trends in sales and fall in profits.*

(k) Rising level of inventories which may include large proportion of slow or non-moving items.

(l) Larger and longer outstandings in bill accounts.

(m) Longer period of credit allowed on sales documents negotiated through the bank and frequent return by the customers of the same as also allowing large discount on sales.

(n) Failure to pay statutory liabilities.

(o) Utilisation of funds for purposes other than running the units.

APPENDIX 16.2

RELIEFS AND CONCESSIONS WHICH CAN BE EXTENDED BY BANKS/ FINANCIAL INSTITUTIONS TO POTENTIALLY VIABLE SICK UNITS UNDER REHABILITATION

I. *Interest Dues on Cash Credit and Term Loan:* If penal rates of interest of damages have been charged such charges should be waived from the accounting year of the unit in which it started incurring cash losses continuously. After this is done, the unpaid interest on term loans and cash credit during this period should be segregated from the total liability and funded. No interest may be charged on funded interest and repayment of such funded interest should be made within a period not exceeding 3 years from the date of commencement of implementation of the rehabilitation programme.

II. *Unadjusted Interest Dues:* Unadjusted interest dues such as interest charged between the date up to which rehabilitation package was prepared and the date from which actually implemented, may also be funded on the same terms as at (i) above.

III. *Term Loans:* The rate of interest on term loans may be reduced, where considered necessary, by not more than three per cent in the case of tiny/decentralised sector units and by not more than two per cent in other cases, the reduced rates in no case being less than the rate of interest charged under Integrated Rural Development Programme (IRDP).

IV. *Principal Dues:* After the unadjusted interest portion of the cash credit account is segregated as indicated at (i) and (iii) above, the balance representing principal dues may be treated as irregular to the extent it exceeds drawing power. This amount may be funded as working capital term loan (WCTL), with a repayment schedule not exceeding 5 years. Interest may be charged on this funded loan at 10 per cent per annum.

V. *Cash Losses:* Cash losses are likely to be incurred in the initial stages of the rehabilitation programme till the unit reaches the break-even level. Such cash losses excluding interest as may be incurred during the nursing programme may also be financed by the bank or the financial institution, if only one of them is the, financier. But if both are involved in the rehabilitation package, the financial institution concerned should finance such cash losses. Interest may be charged on the funded amount at the rates prescribed by IDBI under its scheme for rehabilitation assistance.

VI. *Working Capital:* Need-based working capital should be sanctioned to the unit to enable it to carry on its operations, with interest at the minimum of the band of the prescribed interest rates during the rehabilitation period, where the minimum of the band exceeds 15% (as for instance in the cases of working capital assistance in excess of Rs. 25 lakhs, where it is 16.5%), the rate may be fixed at 15% p.a.

VII. *Contingencey Loan Assistance:* For meeting escalations in capital expenditure to be incurred under the rehabilitation programme, banks/financial institutions may provide, where considered necessary, appropriate additional financial assistance up to 15 per cent of the estimated cost of rehabilitation by way of contingency loan assistance. Interest on this contingency assistance may be charged at the concessional rate allowed for wroking capital assistance.

APPENDIX 16.3

REPORT OF THE COMMITTEE ON INDUSTRIAL SICKNESS AND CORPORATE RESTRUCTURING (GOSWAMI COMMITTEE)*

A Committee under the Chairmanship of Prof. Omkar Goswami set up by the Government to look into the various aspects of industrial sickness and issues relating to corporate restructuring submitted its report in July 1993. The major recommendations of the Committee are as follows:

(a) The responsibility of industrial and corporate reorganisation must shift from secured creditors and the State to the defaulting debtor firms, for bringing about corporate and industrial restructuring.

(b) The Board for Industrial and Financial Reconstruction (BIFR) should be a fast track facilitator by taking decisions instead of seeking clarifications and explanations. The Committee has also suggested some short-term measures for bringing about organisational changes in BIFR. According to the Committee, the Government should appoint eight members who are experts from areas like finance, taxation and corporate law in BIFR at the bench level.

(c) BIFR should make use of winding up provisions of Sick Industrial Companies (Special Provisions) Act of 1985 (SICA), i.e., Section 20(4) more frequently so as to facilitate the sale of unviable units and thereby speeding up the pace of decision making among the affected parties.

(d) There should be 5 self-financing recovery tribunals exclusively for recovering corporate debts to secured creditors. There should be a 'complete code for recovery', i.e., consistent and closed, which can then ensure an independent jurisdiction of these tribunals and so circumvent the problems of overlapping jurisdiction.

(e) In view of the past practices of banks and term lending institutions in terms of unsound project appraisal, poor identification and inadequate provisioning of tainted portfolios, insufficient capital adequacy, etc., the financial institutions have to shoulder larger losses. Therefore, the financial sector requirements should be very closely monitored and expedited so as to quicken the process of industrial restructuring. The RBI guidelines for rehabilitation should need to be altered to abjure the notion of sacrifices and instead address the basic issues in appraisal. The Committee has specified that (i) there should be no write-off of new loans; (ii) if a partial write-off is necessary, it should be explicit and only on part debt; and (iii) the non-written off exposure to be charged and discounted at market rate of interest. Further, write off, if any should be in the form of debt-equity conversion.

(f) The Central Board of Direct Taxes (CBDT) should remove all tax hurdles that prevent banks and financial institutions from converting debt to equity of sick companies particularly, when recommended by BIFR.

(g) The definition of sickness needs to be modified to facilitate early detection. Focus should be on incipient sickness in place of the negative net worth criteria. The definition of sickness should be (i) default of 180 days or more on repayment to term lending institutions or (ii) irregularities in cash credit or working capital for 180 days or more. With the change in definition, SICA should legislate the following procedures.

---

* Reproduced from Company News & Notes, February 1994.

(i) The secured creditor of a 'sick' company would have the option of moving High Courts or Recovery Tribunals to recover the secured assets of the company. It would not be upto the firm to seek time-bound protection from the BIFR;

(ii) If the company refers to BIFR, the Board would instruct the management/ promoter to prepare a reorganisation plan within 90 days that can satisfy secured creditor(s);

(iii) If creditors representing three-fourth of the secured debt were satisfied by the plan, it would become a sanctioned scheme of the BIFR, if not, alternative plan would have to be prepared in consultation with secured creditors, government and labour within another 60 days;

(iv) If the above plan it not accepted by creditors representing more than three-fourth of secured debt, then BIFR would automatically recommend the company to the Recovery Tribunals or to be wound up under SICA (Section 20(4)].

(h) In order to detect sickness at the incipient stage, the Committee has recommended that the irregular Statement (IS) has to be revised and further the Revised Irregular Statement (RIS) should be examined by RBI. Also, the health coding system presently used has to be replaced with four categories [satisfactory, irregular, suspect and Managerial Input Required (MIR) instead of earlier two categories (satisfactory and irregular).

(i) All financial institutions and scheduled commercial banks should prepare a list of defaulting creditors depending upon the frequency and magnitude of defaults and the list should be updated every quarter.

(j) The Tandon and Chore Committee norms have become outdated and therefore it is essential to get away from the interest specific norms and prescribe more flexible company specific, technology specific, demand-specific and product-specific guidelines. Since financial institutions and banks may find difficulties in framing guidelines, it may be necessary for credit rating agencies to prepare such guidelines.

(k) The Companies Act, 1956 should be amended in order to enable the secured creditors to implement de facto changes in management and/or the Board of Directors, in instances of repeated debt defaults.

(l) India has enough labour laws (including provisions in the Industrial Disputes Act, 1957 (IDA) and court judgements to take care of labour interest. Hence, it is unnecessary to have yet another sanctioning authority, viz., the State Labour Commissions under sections 25(N) and 25(O) of IDA Act. Therefore, the Committee recommended the elimination of Section 25(N) and 25(O) of IDA which are working as a barrier in the restructuring of work force in various states.

(m) The Provisional Liquidator (PL), to take care of the company's assets should be appointed by the High Court as soon as BIFR's recommendations are forwarded; and

(n) Interview of several procedures associated with winding up of a firm by Court, there must be five fast track Winding-up Tribunals situated in Bombay, Calcutta, Madras, Delhi and Bangalore. The Government should investigate the possibility of barring overlapping jurisdiction of Civil Courts in the affairs of Winding-up Tribunals. The Committee has also exhorted the Government to seriously consider introducing summary procedures in winding up cases.

Some of the recommendations of the Goswami Committee have been given effect to by amending the Sick Industrial Companies Act.

17

Concentration of Economic Power

Meaning

Concentration of economic power may be defined as the economic position which enables the concern to command control over production or marekt exchange or employment in respect of any good or service. Control over production may result from possession of considerable share of the total productive capacity, control over raw material and other inputs, or exclusive ownership of know-how including patent rights. Market exchange power of a concern refers to its power to influence the supply, price or other terms in respect of the inputs it procures or the product it manufactures and/or sells. Control over employment is related to the percentage of workers in the industry or region that is employed by the concern and its power to influence the terms and conditions in respect of employment.

Prof. C.N. Vakil has defined concentration of economic power as "the capacity to influence economic decisions affecting the lives of large numbers of people, which is wielded by one or more persons, who have some-how obtained such capacity. For example, a dictator who has complete political power over his country has also the capacity to take decision influencing the economic life of the people over whom he rules. Economic power may also be concentrated in the hands of a few persons who, because of their control of the production of certain goods, are in a position to decide their prices irrespective of the interests of the consumer. Economic power is also concentrated in modern times in the hands of larger, well-organised trade unions or similar bodies, who are in a position to dictate economic decisions to employers, either government or private, in their own interest by joint action and coercion which usually results in deadlock of economic activity".[1]

---

[1] C.N.Vakil, "Concentration of Economic Power-Monopoly Houses", in C.N. Vakil (ed.), *Industrial Development of India* (New Delhi : Orient-Longman, 1973), pp, 421-422.

The Monopolies Enquiry Commission appointed by the Government of India under the chairmanship of K. C. Dasgupta in its Report submitted in 1965 distinguished two types of concentration in the industrial sector viz., (i) product-wise concentration. and (ii) country-wise concentration. *Product-wise Concentration* refers to a situation where the production and distribution of a commodity or service is controlled by a comparatively limited number of concerns which are, in their turn, controlled by a single family or a few families. *Country-wise concentration* refers to a situation where a large number of concerns engaged in the production or distribution of different commodities are in the controlling hands of one individual, or family or business group.

Concentration of economic power in the industrial sector may be manifest in any of the following forms :

(i) Considerable share of productive capacity: According to the MRTP Act, if an undertaking, either by itself or together with its interconnected undertakings has licensed capacity for the production of any good which is equivalent to not less than one-fourth of the total installed capacity in India for the production of such good, the undertaking will be deemed a dominant undertaking.

(ii) Control over market : According to the MRTP Act, if an undertaking either by itself or together with its inter-connected undertakings controls not less than one-fourth of the total supply or distribution of any service in India, it will be regarded as a dominant undertaking.

(iii) Large assets : The value of the assets of a concern will also give some indication of the economic power it wields. It is said that in India there is a tendency to equate the size of assets with monopoly.

(iv) Considerable share of employment : The percentage of the total workers of the Industry employed by a concern is sometimes taken to decide the extent of its economic dominance. For example, prior to the Amendment of 1982, the number of workers employed was one of the criteria used by the MRTP Act to describe an undertaking as a dominant undertaking or as a monopolistic undertaking.

CAUSES OF CONCENTRATION

There are a number of factors that contribute to the concentration of economic power. The Monopolies Inquiry Commission (MIC) has mentioned the following causes:

(i) Growth of joint stock companies and technological advances : Development of the joint stock form of business and the economies of scale arising out of technological advances are among the main causes for the growth concentration of economic power. The evolution of the corporation has made it possible for captains of industry to use these economies of scale

to the greatest advantage by putting them in control of large amounts of capital contributed by many.

(ii) Inter-connections : Inter-company investments, inter-locking of directors, mergers, amalgamations, etc., have also contributed to the concentration of economic power

(iii) Managing Agency : The system of Managing Agency supplying managerial skill in different forms and diverse ways has proved a fruitful source of concentration of economic power.

(iv) Controls: The system of controls in the form of industrial licensing, import restrictions, exchange control, etc., have helped the big business. The system of industrial licensing restricted the freedom of entry. As the licensing authority preferred men of proven business ability, the big business groups were on a comparatively advantageous position. Prof. Hazari has observed that the chronological principle, i.e., first come first served basis, followed in the sanction of industrial licences helped the big business to corner licences. Prof. Hazari has also observed that big business houses attempted to pre-empt capacity by obtaining multiple licences for the same product. The MIC also observed that the ability of big businessmen to secure foreign collaboration was another reason for their success in getting new licences.

(v) Inherent opportunities: In the period immediately following independence the very forces which were harnessed to produce the quick industrialisation of the country worked at the same time to concentrate power in industry in a few individuals or families who were already wealthy and powerful. The Mahalanobis Committee has also observed that, in part at least, the working of our planned economic system has encouraged this process of concentration by facilitating and aiding the growth of big business.

(vi) Assistance from financial institutions : The advantage which the big business had over the smaller ones in obtaining assistance from banks and other financial institutions was another factor that contributed to concentration of economic power. Some big business had representatives in the Board of Directors of some of the banks. The Mahalanobis Committee has also observed that the large business had an easier access to the capital market as banks, insurance companies and trusts besides individuals had a preference for investing in shares of big companies. The operation of the economic system with its criterion of credit-worthiness and security lending supported the large and established enterprises against the small and struggling enterprises.

MONOPOLY

Strictly speaking monopoly refers to a situation where the whole market for a product, for which there is no substitute, is controlled by a single firm. Such a situation, however, is very rare. The term monopoly, therefore, is widely used to refer to 'near monopoly' situation and it is common to speak of the 'degree' of monopoly to indicate the extent of control or power of a 'monopolist'. Today it is usual to describe a firm as 'monopolist' if it, by itself or together with a few other firms, controls the major part of the market. For instance, according to the MRTP Act, an undertaking was regarded as a monopolistic undertaking if it, together with not more than two other independent undertakings, controlled not less than one-half of the total production, supply or distribution of any good of the provision of any service.

Sources and types of monopoly

Certain obstacles to entry—that is legal, technical or economic barriers —permit a firm to monopolies an industry and prevent entry of new firms. On the basis of these obstacles, we may distinguish the following types of monopoly:

1. *Natural Monopoly* : Natural monopoly, also known as Legal Monopoly, refers to a monopoly established by the State. There is a general tendency for the State to monopolies the public utilites.

2. *Strategic-Resource Monopoly* : This refers to a situation where a firm has achieved monopoly position by gaining control of an essential input to production process. For example, the International Nickel Company of Canada today owns almost the entire supply of nickel reserves.

3. *Patent Monopoly* : A patent monopoly is a firm upon which government has conferred the exclusive right—through issuance of a patent — to make, use or vend its own invention or discovery. A patent, therefore, enables a firm to profit from its inventions while preventing its adoption by competitors. Such protection is regarded necessary to encourage research and development.

4. *Licensed Monopoly* : Professor C. N. Vakil has used the term [2] licensed monopoly to refer to the situation where the domestic producers are enabled to obtain monopoly power by the protection accorded to them from foreign competition by government.

Monopoly Houses and Monopoly Power

There seems to have emerged a tendency in India to describe the large industrial houses as monopoly houses. Several people have, however, raised objection to this tendency of regarding an industrial house as a monopoly house just because it possesses large assets irrespective of whether it wields any monopoly power or not.

There is an impression that the confusion created by this tendency has led to misdirection of policy and regulation. For instance, it has been criticised that "instead of dealing with the licensed monopoly which is a source of serious handicap to the consumer, government has directed its attention to some so-called monopoly houses—which is the label given to certain large industrial houses, large in the sense that they are in the group of first 20 or 30 houses from the point of view of investment in the country. Even our biggest houses are small compared with the giant industrial concerns of Western countries, with which they are expected to compete in foreign markets. This largeness is due not to production of a single commodity, but due to the existence of a multiplicity of concerns of a diverse nature, which some of the big business houses have under their control. It is the largeness of resources that have attracted government's attention and is confused with monopoly. This has happened because government is anxious to remove or limit concentration of economic power, to which reference has been made in the constitution".[3]

---

[2] C.N. Vakil, *op. cit.*

It may be the view that "the essence of monopoly is concentration of economic power" that tempts to dub the large houses as monopolies. Corvin D. Edwards observes that "there are three types of concentrated economic power, each of which imperils competition in different ways. One is derived from control of sales (or purchases) in a particular industry. It is customarily described as monopoly (or monopsony). A second is derived from vertical integration on a scale sufficient to provide a compelling advantage over non-integrated enterprises. The third type of power is that which springs from giant size". He proceeds to say : "Bigness may destroy competitors, eliminate competitive initiative, and lead to the adoption of restrictive policies even when the big enterprise is a conglomerate concern without monopolistic power in particular markets".[4] It may be this fear that leads to the demand for control of 'big business'. Of course, it is possible that monopoly power may exist without concentration of economic power and *vice versa*.

It should also be remembered that "monopoly is not synonymous with monopoly power. Also, a monopolist is not a concomitant of monopoly power. Monopoly power implies the exercise of substantial control, presently or potentially, by a seller or a group of sellers, individually or collectively. Monopoly power may be exercised by a monopolist, a duopolist, an oligopolist or a combination of sellers. There may be a single seller in the market and yet he may not be able to exercise any "substantial control over the market."

CONSEQUENCES OF CONCENTRATION

The common attitude is against concentration of economic power due to the various evils associated with it. However, concentration has some beneficial effects also though in many instances the harmful effects may tend to outweigh the beneficial effects.

The majority opinion of the Monopolies Inquiry Commission was that concentration of economic power has fostered economic development in

---

[3] C. N. Vakil, *Ibid.*, p. 419.

[4] Cited in S.R. Mohnot, *Monopoly Concentration and Industrial Licensing* (Calcutta : Oxford and IBH Publishing Co., 1968), p. 52.

India. The large industrial houses supplied managerial skill of high quality in abundance and as a result, production could be carried on at a high level with good dividends for firms and there have been very few failures of companies under group control.

Whatever may be the criticisms against the large industrial houses, one cannot ignore the contribution they have made to the industrial development of the country. And they can still play an important and positive role in the industrial development of the country because of the resources—financial, managerial, technological and experience-they possess. In this context it is also relevant to state the observation of Mr. R.C. Dutt, one of the members of the MIC : "In the process of setting up large industrial units, or as a result thereof, concentration of economic power may have been achieved and those in whom such power is concentrated may have contributed to the process of development. And yet the fact of concentration as such cannot be regarded as responsible for such development".

The evil effects of concentration and monopoly power should be viewed with due seriousness. The common evil effects of concentration of economic power are the following :

(i) Exploitation of consumers through unfair trade practices including monopolistic and restrictive trade practices;

(ii) When the market is not competitive the producers may not seriously try to improve the quality and productivity; in a sellers's market quality and productivity may even decline;

(iii) The large firms may try to block the entry of new and small entrepreneurs;

(iv) Concentration of economic power might further tend to increase the economic disparities causing social tensions;

(v) Concentration of economic power may tempt to corrupt the political and administrative system. The MIC has stated : "Power corrupts and absolute power corrupts absolutely. This is often said of political institutions, but it is said to be no less true of economic power."

(vi) R.C. Dutt in his note of dissent has stated that in fact concentration of economic power has hindered the growth of managerial class, more specially at the top levels of management. Economic concentration restricted top level management and executive authority among the members of the family.

(vii) It is also argued that concentration of economic power might lead to misdirection of investment.

(viii) Concentration of economic power may destroy small firms. As Justice Madhusudhan, the Chairman of the MRTP Commission has stated, the big fishes may swallow the small fishes.

CONCENTRATION AND MONOPOLY POWER IN INDIA

Prevention of concentration of income and wealth and distributive justice have been among the major objectives of economic policy in India. However, there was a feeling that the fruits of development were not equitably distributed. In 1960, Government of India appointed the *Distribution of Income and Levels of Living Committee* under the chairmanship of Dr. P.C. Mahalanobis to (i) ascertain the extent to which the operation of economic system had resulted in concentration of wealth and means of production, (ii) review changes in levels of living during the first two plan periods; and (iii) study recent trends in distribution of income and wealth. Though the Committee notices some trends towards concentration arising from functioning of the economic system, the Committee did not make any clear conclusion. In fact, the Committee felt that more detailed exploration into certain aspects of concentration of economic power was needed.

Prof. R.K. Hazari, who was appointed Honorary Consultant by the Planning Commission in 1966 to study the operation of the licensing system under the Industries (Development and Regulation) Act, 1951, disclosed that the licensing system favoured the growth of the large industrial houses.

In 1964, Government of India appointed the Monopolies Inquiry Commission (MIC) under the chairmanship of K.C. Dasgupta. The terms of reference of the Commission included, among other things, the following : (i) to inquire into the nature and effects of concentration of economic power in private hands and the prevalence of monopolistic and restrictive practices in important sectors of economic activity other than agriculture with special reference to : (a) the factors responsible for such concentration and monopolistic and restrictive practices, and (b) their social and economic consequences; (ii) to suggest legislation and other measures that might be considered necessary in the light of such inquiry, including any legislation to protect essential public interest and the procedure and agency for the enforcement of such legislation.

The Commission in its Report submitted in 1965 mentioned the causes of concentration of economic power in the Indian private corporate sector (which we have mentioned in a previous section of this chapter) and gave an account of the extent of concentration in certain important cases.

Product-wise Concentration

The Monopolies Inquiry Commission investigated product-wise concentration * in respect of 100 commodities. According to the Commission, where the share of the three top producers of a particular product is 75 per cent or more, the concentration can be considered as *high*. Concentration may be regarded a *medium* where this share is more than 60 per cent, but less than 75 per cent; and it is *low* where it is more than 50 per cent but less than 60 per cent. Where the share of the three top enterprises is less than 50 per cent, concentration may be considered to be *nil*.

---

* **The definitions of product-wise concentration and country-wise oncentration are given in the beginning of this chapter.**

According to findings of the Commission, the products with high concentration were infant milk food, kerosene oil, petroleum, stoves (pressure type), fluorescent lamps, dry batteries, sewing machines, domestic refrigerators, typewriters, clocks, time-pieces, matches, soap, leather footwear, rubber and canvas footwears, tooth paste, talcum powder, razor blades, cigarettes, medicines, cars, commercial vehicles, jeeps, scooters, tyres and tubes, pistones, spark plugs, storage batteries, galvanised sheets (plain), roofing sheets and building boards.

Products with medium concentration were biscuits, electric fans, lamps, radio receivers, liver extract (oral), bicycles and bicycle chains and free-wheels and cement.

Products with low concentration were woollen fabrics, worsted knitting yarn, hurricane lanterns, writing and printing paper, pencils and stoneware pipes.

Products with nil concentration were tea, coffee, sugar, vanaspati oil (milled), dhotis, sarees, long cloth, textiles (poplin, crepe, twill), coal, blankets and rugs, lamp wares, sanitary wares and commercial plywood.

Country-wise Concentration

To ascertain the country-wise concentration the Commission examined data regarding 2259 companies which appeard to belong to one or the other of the 83 big business groups that were operating in the country. For the purpose of the study 'a business group' was taken to comprise all such concerns which were subject to the ultimate and decisive decision-making power of the controlling interest in the group-master. Out of the 83 business houses, 8 were left out becasue the total assets under their control did not exceed Rs. 5 crores. The Commission, thus, analysed 75 business houses controlling 1536 companies. The proportion of assets and paid-up capital of the 75 business groups to those of all non-government and non-banking companies worked out to be about 47 per cent and 44 per cent respectively. The Tata group toped the list followed by the Birlas.

REMEDIAL MEASURES

There is no disagreement that concentration of economic power to the common deteriment should be prevented. There are different measures that can help prevent such concentration. The most commonly taken measures have been used in India also. They are outlined below:

1. *Regulation of Private Business :* The need to regulate private business to ensure that their operations do not become prejudicial to public interest needs no emphasis. In the context of the confused thinking on the concentration of economic power and the host of controls and restrictions on the private sector, the veteran industrialist J.R.D. Tata in a Memorandum to the Government of India observed : "It is strange that while so much has been talked about 'concentration of economic power', no attempt has been made to define what is precisely meant by it, either in terms of its actual characteristics or of the uses to which it has been put. Thus, in the case of most major firms the area of managerial decision-making is itself so small now-a-days as to raise doubts as to what economic power they can really exercise. In all large industries, the level of production permitted, the pattern of such production, the prices at which sales can be made, wage levels, bonus payable, the issues of shares and debentures, the terms of such issues and many other matters, are all dictated or determined by Government or Government appointed bodies. In reality, therefore, whatever 'concentration of economic power' really exists or can be meaningfully wielded in the Indian context can only come from the possession of ill-gotten fortunes and secret funds which, in turn, are used to obtain favours by corrupt and corrupting means". [6]

Some laws have specific provisions to control concentration of economic power to the common detriment. The MRTP Act was designed with the main objectives of prevention of concentration of economic power to the common detriment; and control of monopolistic and restrictive trade practices that are prejudicial to public interest. It provided that, mergers-amalgamations, take-overs, and substantial expansion by dominant and large undertakings required the prior approval of the Government.* The Companies Act empowers the government to regulate the formation of managerial, administrative and financial integration and inter-company investments. The Industries (Development and Regulation) Act (IDRA) empowers the government to regulate the establishment of new undertakings, substantial expansion, manufacture of new article, etc., and to regulate or restrict the role of different categories of undertakings like private, joint and co-operative, and small and large. The IDRA also empowers the government to exercise control over the management or to take over the management of any undertaking in the public interest.

The Essential Commodities Act and IDRA empower the government to regulate the quality and quantity of output, price and distribution of any commodity that may be notified by the government.

---

[6] Cited in C. N. Vakil, *op. cit.*, p. 421.

* These provisions of the MRTP Act were scrapped in 1991.

The appointment of government nominees or nominees of the financial institutions to the management board of the industrial undertakings. The power of the financial institutions to exercise the *convertibility option* had also been designed to regulate the functioning of the large private sector undertakings.

2. *Encouragement of small and new entrepreneurs :* Another measure to check concentration of economic power is to encourage small and new entrepreneurs and to restrict the role of the large industrial houses to certian sectors only. For instance, the Industrial Licensing Policy announced in 1970 made it clear that the role of the large industrial houses would be restricted mostly to the *core* and *heavy investment* sectors. The role of large-scale sector is further restricted by reserving a large number of items for the exclusive manufacture in the small-scale sector.

3. *Expansion of Public, Co-operative and Joint Sectors :* The abuses of the private economic power can be considerably reduced by the expansion of the public, joint and co-operative sectors.

The major objectives of the public sector, among other things, include to gain control of the commanding heights of the economy and to put up an effective competition to the private sector. As clear from the Industrial Policy Resolution, the future development of the most important 17 industries has been the exclusive right of the State and in 12 other industries the State is to play an active role. Further, the State has the right to enter any other industry. Thus the public sector has been assigned a dominant role. Public sector's role has been expanding in the distribution of essential goods. There has been a demand that the public sector should enter the consumer goods sector in a big way.

It is expected that the joint sector will enable the utilisation of the resources and talents of the private sector with the social orientation of the public sector. The growth of the co-operative sector will promote economic democracy and discourage concentration of economic power to the common detriment.

4. *Progressive Taxation :* Progressive taxation can also help check concentration of economic power. But very high rates of tax may become a disincentive for investment and may encourage tax evasion.

5. *Ceiling on Property :* Ceiling on income and property has also been suggested to prevent concentration. This measure may, however, also discourage hardwork, investment and growth.

6. *Other Measures :* The Monopolies Inquiry Commission which suggested some of the above measures also suggested the following measures :

(i) Imports should be liberalised.

(ii) Political parties should not accept any financial or other assistance from the business houses.

(iii) Corruption from the administrative machinery should be removed.

(iv) Consumer associations should be set up to protect the interests of consumers.

LARGE HOUSES AND COMPANIES

The assets and turnover of the large houses and companies have grown rapidly.

An industrial house or company with assets of Rs. 100 crores or more may be regarded as a large house/company. This cut-off point of assets is taken here because an undertaking which either by itself or together with interconnected undertaking had assets of Rs. 100 crores or more was required to be registered under section 20(a) of the MRTP Act for the purpose of control of concentration of economic power to the common detriment (before the amendment of this Act in 1985, this asset limit was Rs. 20 crores).

As on 31st March 1990, there were 83 large industrial houses and 31 single large undertakings not belonging to any large house, each with assets of not less than Rs. 100 crores.

The concept of *industrial/business house or corporate group* denotes a conglomerate of firms under the control of a unified management. For example as on March 31, 1990 the house of Birla consisted of 166 undertakings and that of Tata 85 undertakings. The decision-making authority of such a group controls important decisions pertaining to the firms under the group.

The following table lists the top 20 large houses of India.

The topmost position has always been occupied by either the Tata or Birla. In most of the years Tata occupied the top position in terms of assets. Besides this, the ranking of the large houses has changed over the years, some slipping down and some inching up. Some new houses have figured in the list recently. Reliance and M.A. Chidambaram are recent entrants to the list of the top twenty.

Diverse Views on the Growth of Large Corporations

There are diverse views on the role of large houses and companies in India. One of the frequent arguments is that the growth of the large corporations will result in the concentration of economic power to the common detriment and that it will adversely affect competition and will even influence the political scene. The popularity of this view, particularly in the

1960s and 70s, resulted in the imposition of lot of restrictions on the big business in India. This is clear from the MRTP Act, industrial policy, the convertibility clause in the loan agreements between financial institutions and large borrowers, etc.

TABLE 19.1

The Top 20 Large Industrial Houses (As on 31st March, 1990)

Sl. No.	*Name of Industrial House*	*No. of Undertakings*	*Value of assets (Rs. in Crores)*
1	Tata	85	8630.93
2	Birla	166	8473.35
3	Reliance	15	3600.27
4	Thapar	49	2177.15
5	J.K. Singhania	62	2139.00
6	Larsen and Toubro	7	1681.52
7	Modi	44	1399.37
8	Bajaj	34	1391.06
9	Mafatlal	44	1343.35
10.	M.A. Chidambaram	35	1273.35
11	Hindustan Lever	16	1209.46
12	United Breweries	47	1189.24
13	T.V.S. Iyenger	39	1177.10
14	I.T.C.	17	965.13
15	Shri Ram	18	933.93
16	A.C.C.	7	902.72
17	Oswal Agro	3	870.34
18	Mahindra and Mahindra	9	773.55
19	Essar	12	756.49
20	Kirloskar	27	735.51
	Total	746	41523.00

Source: Company News and Notes, August, 1991.

However, there is also a strongly opposing view which upholds the positive role that the big business can play. Some of the industrial policy modifications made in the 1980 was a reflection of the recognition, *aibeit* to a limited extent, of the positive role of the large corporations. This was reinforced by the recent policy changes.

It is quite evident that the restrictions on the big houses have had many adverse effects — they have retarded competition, decelerated growth in the industrial and consequently in other sectors, and contributed to the foreign trade gap. For example, in the early seventies, having failed to make any headway within India, the only alternative left for the Birla was to set up industries in other countries and it put up several successful companies in all the ASEAN countries. "This was surely a paradox. The same government which refused us permission to set up manufacturing capacities within the country, allowed us to set up industries outside the country for the same products for which it had said 'no' in India. Thus, we set up a viscose staple fibre plant in Thailand, and started exporting fibre back to India".[7]

As pointed out elsewhere in this book, the deregulations and liberalisations of the 1980s have increased competition and imparted more dynamism to the economy and the benefits of these are accruing to the consumers. It is indeed a paradox that laws like the MRTP Act which were designed to prevent monopoly have in effect restricted competition. The MRTP Act has helped to protect the market position of the large houses by restricting the competition between the large houses. Further, the policy of reserving products for the small-scale sector "contributes to higher prices and runs counter to the government's professed anti-monopoly position, by confirming a near-monopoly or oligopoly position for those larger firms that were producing the reserved product before reservation. They are often firms that had been able to take advantage of some scale economies before reservation. They can no longer expand and are protected from competition from other large potentially efficient firms. In industries where such firms continue to produce output of high quality after reservation, they have a good and protected market. They can, if they wish, take advantage of their protected position to raise their prices and earn a monopoly rent".[8]

The so called large houses of India are indeed too small when compared to the giants based in other countries. Further, the total assets of the largest private *industrial house* are less than half of the assets of the largest public sector company in India. As pointed out in the chapter on the Multinational Corporations, the annual turnover of many multinationals is larger than the GNP of a large number of countries. In comparision to that, the turnover of the largest industrial house in India in 1987 was only about two per cent of India's GNP and the aggregate turnover of the 20 largest houses was only about 20 per cent of the GNP. Smallness of the size of the firms often adversely affects their competitiveness in the international market. Indeed, the government of India's policy to promote export and trading houses and the recent industrial policy liberalisations are a reflection of the recognition of this fact.

Many products require investment of several hundreds of crores of rupees for setting up the manufacturing facilities. Only large corporations are in a position to undertake the manufacture of such products. Similarly, only large corporations are in a position to make huge investments in research and development. It is, therefore, no wonder that in India the large houses have been permitted to invest in the core industries involving high technology and heavy investment.

---

[7] Aditya Birla, "State and industry must work together", *Business India* (10th Anniversary issue), 30th April 1988, p. 94.

[8] George Rosen, *op. cit.*, p. 116.

More than four decades ago, Jawaharlal Nehru had observed that "the economy based on the latest technical achievements of the day must necessarily be the dominating one. If technology demands the big machine with all its... consequences must be accepted... (In) any event, the latest technique has to be followed."[9] However, technology, including scale economies, did not receive sufficient attention under the Indian policy. However, of late more attention has been paid to this aspect. For example, "earlier, our filament yarn plants were of 1000 tonnes per annum (tpa) size and today, the government insists on a minimum size of 15,000 tpa.[10] Government has recently specified minimum size of productive capacity, on the basis of economies of scale, in a large number of industries.

The bias against largeness resulted in the creation of a large number of units of uneconomic size in several industries causing high cost of production. Of course, there are several areas where the small-scale units have advantage; but it is equally true that the large firms' role in the development of several very important sectors is undisputable.

One wrong impression some people have is that all the large houses or companies make huge profits. However, there are instances of the large houses and companies incurring losses or making only small profits.

It should also be noted that, although there are usually a small number of very large shareholders, the large houses and companies are owned by many thousands, in some cases even millions, of shareholders.

We have several laws to control the business. Hence, there is no reason to fear that the growth of large houses and companies will lead to an uncontrolled business situation.

Many of those who criticise the large houses in the private sector seems to ignore the dangers of the concentration of economic power in the public sector. Indeed, the growth of concentration of economic power in the public sector is also detrimental. Public sector monopolies could be more dangerous than the private sector monopolies because the public sector monopoly power is supported by the statist powers. It is a paradox and irony that some of the import laws designed to check the abuse of monopoly power and unfair trade practices are not applicable to the public enterprises. In fact, the High-Powered Export Committee on Companies and MRTP Acts, which recommended that the provisions of the MRTP Act relating to the control and prohibition of monopolistic, restrictive and unfair trade practices should be applicable to the pubic sector enterprises, observed: "The beneficiary of monopoly legislation is the consumer and it is only fair and reasonable that undertakings owned and controlled by the government should be subject to the same type of rigour and discipline as the private sector undertakings where the interests of the consumers are involved." The government has not, however, accepted this recommendation.

---

[9] Cited by George Rosan, *Ibid.*, p. 22.

[10] Aditya Birla, *op. cit.*, p. 94.

There is a feeling that some public enterprises have grown to undesirably large sizes. Some time back there was a proposal to divide the monopolithic organisation LIC into four or so units. However, this proposal was shelved because of trade union and political pressures. Similarly, the proposal to restructure the Kerala State Road Transport Corporation into a small number of independent units to improve the operational efficiency also was dropped due to political reasons. Thus, vested trade union and political interests seems to be getting predominance over the consumer and national interests in respect of many public enterprises in India. Time has come for selective *privatisation* to protect the interests of the consumers and the general public.

Scope for a substantial growth of the large houses and companies in the private sector, as also for small and medium enterprises, is provided by the new economic policy which has abolished licensing for most of the industries and the MRTPA restrictions on mergers, amalgamations and take-overs. This has given rise, according to reports, to a merger mania.

18

MRTP ACT

The Monopolies and Restrictive Trade Practices Act, 1969, brought into force from 1st June 1970, was a very controversial piece of legislation.

The principal objectives of the MRTP Act which extends to the whole of India except to the State of Jammu and Kashmir, were :

1. Prevention of concentration of economic power to the common detriment, and
2. Control of monopolistic, restrictive and unfair trade practices which are prejudicial to public interest.

Amendments

The MRTP Act was significantly amended in 1982, 1984, 1985 and 1991.

One of the amendments of 1982 was the redefinition of *dominant undertaking*. Before this amendment, a dominant undertaking was one which either by itself or with interconnected undertakings controlled not less than one-third of the total production, supply or distribution of any goods or the provision of any service in India or any substantial part thereof. With the 1982 amendment, this market share for consideration of dominance became one-fourth instead of one-third. Since the amendment of 1982, the share of installed capacity of an undertaking in the total installed capacity for the production of a commodity in India also became a factor for consideration of dominance.

Before the amendment of 1982, the MRTP Act had distinguished another category of undertaking, namely, *monopolistic undertaking* which meant an undertaking which either by itself or together with inter-connected undertakings controlled not less than half of the market share.

With the amendment of 1982, goods exported out of India are excluded from the calculations for the purpose of determining market dominance.

The MRTP Act was amended in 1984, to bring unfair trade practices under the control of the Act. Further, in 1984, certain provision of the Companies Act related to imposing restrictions on the acquisition and transfer of shares were transferred to the MRTP Act. The amendment of 1984 also empowered the central government to direct severance of inter-connection between undertakings in certain cases.

The amendment of 1985 was to raise the asset threshold of undertaking (s) from Rs. 20 crores to Rs. 100 crores for applying the provisions of the MRTP Act relating to prevention of concentration of economic power.

Recent Changes

The Industrial Policy Statement of July 24, 1991, announced very drastic changes in the MRTP Act, viz., repeal of the provisions of Act pertaining to concentration of economic power, except the provisions empowering the government to defuse concentration of economic power to the common detriment. In other words, the main thrust of the MRTP Act hereafter will be to the achievement of prevention of monopolistic, restrictive and unfair trade practices. Thus, the 'M' has almost been knocked out of the MRTP Act.

The provisions of the MRTP Act pertaining to the concentration of economic power were much criticised because of their negative impact on growth and competition.

The MRTP Act sought to prevent the concentration of economic power to the common detriment by preventing those developments which might result in the concentration of economic power such as substantial expansion of existing undertakings; mergers and amalgamations; takeovers; and, interconnection of undertakings. Accordingly, the MRTP companies (i.e., dominant undertakings with assets of Rs. one crore or more and other undertakings having assets, including that of interconnected undertakings, of Rs. 100 crores or more) had to obtain prior approval of the central government for any of the developments mentioned above.

As the new industrial policy Statement confesses, with the growth complexity of industrial structure and the need for achieving economies of scale for ensuring higher productivity and competitive advantage in the international market, the interference of the government through the MRTP Act in investment decisions of large companies became deleterious in its effects on Indian industrial growth.

It has, therefore, been decided to repeal the provisions of the MRTP Act requiring prior governmental approval for expansion of existing undertakings; establishment of new undertakings; merger, amalgamation and takeover; and appointment of certain directors.

The thrust of the MRTP Act in future will be on the control of restrictive and unfair trade practices.

The Government, however, retains the power to defuse or break-up concentration of economic power to the common detriment. If the central government is of the opinion that the working of an undertaking is prejudicial to the public interest, or has, led or is leading, or is likely to lead, to the adoption of any monopolistic or restrictive trade practice, the government is empowered by the MRTP Act to direct :

(i) the division of any trade of the undertaking by the sale of any part of the undertaking or assets thereof; or

(ii) the division of any undertaking or interconnected undertakings into such number of undertakings as the circumstances of the case may justify.

MRTP COMMISSION

In accordance with the provisions of the Act, the Government of India has set up a Commission known as the Monopolies and Restrictive Trade Practices Commission. The Act provides that the Commission shall consist of a chairman, and not less than two and not more than eight other members, to be appointed by the Central Government. The chairman shall be a person who has the qualification to be a judge of the Supreme Court or of a High Court, and the members thereof shall be persons of ability, integrity and standing, who have adequate knowledge or experience of, or have shown capacity in dealing with problems relating to economics, law, commerce, accountancy, industry, public affairs or administration.

The Act empowers the Central Government to appoint a Director-General of Investigation and Registration, and as many Additional, Joint, Deputy or Assistant Directors-General of Investigation and Registration, as it may think fit, to conduct investigations for the purposes of this Act, and for maintaining a register of agreements subject to registration under this Act, and for performing such other functions as are, or may be, provided by, or under this Act. The Director-General may authorise any one of the Additional, Joint, Deputy or Assistant Directors-General to function as the Registrar of Agreements subject to registration under this Act.

Jurisdiction and Powers of the Commission

The MRTP Commission is vested with powers to inquire into restrictive, monopolistic and unfair trade practices.

The Commission may inquire into any restrictive trade practice either on the application of the Director-General of Investigation or upon a reference made to it by the Central or a State Government, or on receiving complaint from any trade or consumer association having a membership of not less than 25 persons, or 25 or more consumers, or upon its own knowledge or information.

The Commission may inquire into any monopolistic trade practice upon a reference made to it by the Central Government or upon its own knowledge or information.

Where a complaint about any restrictive trade practice is received by the Commission from a trade or consumers' association or consumers as stated above, the Commission may, before issuing any process requiring the attendance of the person complained against, require the Director-General to make, or cause to be made, a preliminary investigation in such a manner as it may direct and submit a report to the Commission to enable it to satisfy itself as to whether or not the complaint requires to be inquired into. Such a preliminary investigation may be made by the Director-General also upon his own knowledge or information, or on a complaint made to him.

For the purpose of an inquiry under this Act, the Commission has the same powers as are vested in a Civil Court under the Civil Procedure Code, 1908, in respect of:

(i) Summoning a witness and his examination on oath;
(ii) Discovery and production of evidence;
(iii) Reception of evidence on affidavits;
(iv) Requisitioning public records from a court or an office; and
(v) Issuing a commission for the examination of a witness.

The proceedings before the Commission are judicial proceedings and the Commission is deemed to be a Civil Court.

The Commission is empowered to require any person:

(a) To produce before, and allow to be examined and kept by, an officer of the Commission specified by it in this behalf, such books, accounts or other documents in the custody or under the control of the person so required as may be specified or described in the requisition, being documents relating to any trade practice, the examination of which may be required for the purposes of this Act; and

(b) To furnish to an officer so specified such information as respects the trade practice as may be required for the purpose of this Act or such other information as may be in his possession in relation to the trade carried on by any other person.

During an inquiry before the Commission into any monopolistic, restrictive or unfair trade practice, the Commission is empowered to grant a temporary injunction, restraining the undertaking or person concerned from carrying on any monopolistic, or restrictive, or unfair trade practice.

There was no provision in the MRTP Act to award compensation for the loss or damage caused by monopolistic, restrictive or unfair trade practices. The Sachar Committee observed : "It is a well established principle of jurisprudence that for every wrong there must be a remedy. It is approved that prohibited practices, if indulged in, are likely to cause grave loss or damage to many consumers. But in the Act there is no provision for awarding the damages....This is a highly unsatisfactory state of affairs." The Committee pointed out that the corresponding Acts in the USA, Switzerland, Japan, Australia, Canada, etc., provide for such compensation, and recommended that the MRTP Act should be modified by incorporating provisions in it for the payment of compensation to the affected party. Accordingly, a new Section, 12-B, was inserted by the Amendment Act of 1984 to empower the MRTP Commission to award compensation for the loss or damage caused by monopolistic, restrictive or unfair trade practices.

Monopolistic, Restrictive and Unfair Trade Practice

As mentioned earlier, the MRTP Act is now concerned mostly with the control of monopolistic, restrictive and unfair trade practices which are prejudicial to the public interest.

Control of Monopolistic Trade Practice

A monopolistic trade practice is a trade practice which has, or is likely to have, the effect of unreasonably preventing or lessening competition in the production, supply or distribution of any goods or services; limiting technical development and capital investment to the common detriment; or allowing the quality of goods or services to deteriorate.

Chapter IV of the Act empowers the Central Government to control and prohibit those monopolistic trade practices that are, or are likely to be, prejudicial to the public interest.

A monopolistice trade practice shall be deemed to be prejudicial to the public interest, if having regard to the economic conditions prevailing in the country, and to all other matters which are relevant in the particular circumstances, the effect of the trade practice is or would be:

(a) To increase unreasonably the cost relating to the production, supply or distribution of goods or the performance of any service;

(b) To increase unreasonably :
  (i) the price at which goods are sold, or
  (ii) the profits derived from the production, supply or distribution of goods or from the performance of any service;

(c) To reduce or limit unreasonably competition in the production, supply or distribution of any goods (including their sale or purchase) or the provision of any service;

(d) To limit or prevent unreasonably the supply of goods to consumers or the provision of any service;

(e) To result in a deterioration in the quality of any goods or in the performance of any service.

Section 31 provides that where it appears to the Central Government that the owners of one or more monopolistic undertakings are indulging in any monopolistic trade practice, or that monopolistic trade practices prevail in respect of any goods or services, the government may refer the matter to the MRTP Commission for an inquiry and the Commission shall, after such hearing as it thinks fit, report to the Central Government its findings thereon. The Commission may make such an inquiry also on its own motion. If such an inquiry finds that any monopolistic trade practice operates or is likely to operate against the public interest, the Central Government may pass such an inquiry also on its own motion. If such an inquiry finds that any monopolistic trade practice operates or is likely to operate against the public interest, the Central Government may pass such orders as it may think fit to remedy or prevent any mischiefs which result or may result from such trade practice. Any order made by the Central Government in this regard may include an order:

- (a) Regulating the production, storage, supply, distribution or control of any goods by the undertaking or the control or supply of any service by it and fixing the terms of sale (including prices) or supply thereof;
- (b) Prohibiting the undertaking from resorting to any act or practice or from pursuing any commercial policy, which prevents or lessens, or is likely to prevent or lessen, competition in the production, supply or distribution of any goods or provision of any services;
- (c) Fixing standards for the goods used or produced by the undertaking;
- (d) Declaring unlawful, except to such extent and in such circumstances as may be provided by or under the order, the making or carrying out of any such agreement as may be specified or described in the order;
- (e) Requiring any party to any such agreement as may be so specified or described to terminate the agreement within such time as may be so specified, either wholly or to such an extent as may be so specified.

Exemptions

A monopolistic trade practice is deemed to be prejudicial to the public interest, except when it is :

- (i) Authorised by the Central Government; or
- (ii) Found necessary by the Central Government to (a) meet the defence requirements; (b) ensure the maintenance of essential services; or (c) give effect to the terms of an agreement to which the Central Government is a party.

Control of Restrictive Trade Practice

A restrictive trade practice is a trade practice which has the effect, actual or probable of restricting, lessening or destroying competition. Such trade practices may tend to obstruct the flow of production or bring about manipulation of prices or conditions of delivery etc. to the common detriment.

Indeed, every monopolistic trade practice is also a restrictive trade practice. The distinction between the two is based, perhaps, on the Monopolies Inquiry Commission, which confined the word "restrictive trade practices" to mean restrictive trade practices other than those pursued by monopolists. In the words of the Commission, "every monopolistic practice is, on the face of it, a restrictive trade practice. Indeed, sometimes the two words are used indiscriminately. We shall confine the words restrictive trade practice to mean practices other than those pursued by monopolies which obstruct the free play of competitive forces or impede the free flow of capital resources into the stream of production or of finished goods in the stream of distribution or of any point before they reach the hands of the ultimate consumer."

Possible Restrictive Trade Practices

The following are some common types of restrictive trade practices :

(i) *Concert or Collusion/Cartels*: That is, collusive action on the part of manufacturers or suppliers in fixing prices or terms of sale to lessen competition; or concert against manufacturers / suppliers to divide markets to eliminate competition.

(ii) *Price Discrimination* : This refers to the practice of selling goods or services where their are no or nominal cost differences at different effective prices to distinct and separate groups of customers.

(iii) *Predatory Pricing*: This is a practice of temporarily selling at prices below cost with the intention of driving out existing competitors or warding off competitors about to enter the market so that the market power of the person resorting to such a trade practice is either enhanced or maintained.

(iv) *Tie-up sales*: Manufacturers or suppliers of fast-moving products may tie up sales of such products with the sales of slow-moving products resulting in distortion in competition in the field of slow-moving products.

(v) *Full-line Forcing*: This is the practice that requires a buyer to purchase quantities of each item in a product range in order to be able to buy one of them. This is a more drastic variation of tie up sales.

(vi) *Exclusive Dealing*: This is a trade practice in which the supplier or the manufacturer insists that the dealer will exclusively deal in the products of the manufacturer/ suppliers, that is to say, he will not deal in the products of the competitor/ competitors.

(vii) *Area Restriction*: This is a trade practice whereby a restriction is placed by the manufacturer on the dealer to make supplies only within a fixed area or designated territory and not to sell outside that area.

(viii) *Resale Price Maintenance:* This is a trade practice under which a manufacturer fixes a price at which a retail shop, which he does not own, must re-sell his product to the public or at which a wholesale business, which he does not own, must re-sell that product to a retailer.

Control of Restrictive Trade Practices

Under the MRTP Act, restrictive trade practices are not prohibited except in so far as re-sale price maintenance is concerned; but here, too, there is a provision for getting exemption for any class of goods.

However, barring those exempted under the Act (mentioned under the title *Exemptions)*, the agreements which relate to a restrictive trade practice or practices* (wide enough to cover arrangements and understanding — the MRTP Act covers restrictive trade practices through agreements as also otherwise) are required to be registered with the Registrar of Agreements, authorised by the Director-General of Investigation and Registration, so that he can get them evaluated by the MRTP Commission as to whether the restrictive practice is or is not against the public interest. Registration, however, is not a necessary prerequisite for starting an enquiry, for it can be started without the formality of registration. The initial burden is on the Registrar to show that a trade practice is restrictive, and thereafter it shifts on the party proceeded against to show that the practice, though anticompetitive, is not against the public interest in the facts and circumstances of the case.

There is no punishment for indulging in a restrictive trade practice (with the exception of re-sale price maintenance); but there is punishment if there is a violation of a "cease and desist" order of the Commission.

Once the MRTP Commission finds that the impugned restrictive trade practice is prejudicial to the public interest, it has powers to pass an order directing:

(a) That the practice shall be discontinued or not repeated (these are called "Cease and Desist Orders");

(b) That the agreement relating to the said practice shall be void (becomes unenforceable by any Court);

(c) That the agreement relating to the aforesaid practice be modified in a specified manner.

Instead of passing an order, the Commission may, on an application by a person, party to a restrictive trade practice, permit him to take steps within such specified time as may be necessary to ensure that the trade practice is no longer prejudicial to the public interest. The Commission has wide powers to:

---

* For details, see *Appendix* 16.2.

(a) Make provisions necessary or desirable for the proper execution of its order; and

(b) Amend on revoke its order.

An order made by the Commission may be general in application or limited to a particular class of traders, trade practice, locality or to a particular trade practice.

An appeal against an order of the Commission lies only to the Supreme Court.

Evaluation of Public Interest

For the purpose of any proceedings before the Commission, a restrictive trade practice is deemed to be contrary to the public interest unless the respondent(s) can prove first that it can pass through one or more of the eight gateways set out in Section 38(1) of the Act and further that, in each case, the restriction is not unreasonable, having regard to the balance between those circumstances justifying the gateways and any detriment to the public interest resulting or likely to result from the restrictions.

The gateways are as follows :

(a) The restriction is necessary to protect the public against physical injury or damage to premises.

(b) The removal of restriction would deny to the public specific and substantial benefits resulting from the agreement.

(c) The restriction is necessary to counteract anti-competitive measures taken by a person (e.g., a single large firm or a monopolist) at the same level of trade.

(d) That the restriction is necessary to enable the respondent to negotiate fair terms:

  (i) for the supply of goods to or for the acquisition of goods from any one person who controls a preponderant part of trade in those goods;

  (ii) for the supply of goods to any person who either alone or in combination with any other person controls a preponderant market of such goods.

(e) The removal of restriction would result in serious and persistent unemployment in those areas where the industry is located.

(f) The removal of restriction would have an adverse effect on export earnings which are substantial either in relation to the total exports of India or to the total business of the industry.

(g) The restriction is necessary in order to maintain another restriction found by the Commission not to be contrary to the public interest.

(h) That the restriction does not directly or indirectly restrict or discourage competition to any material degree in any relevant trade or industry and is not likely to do so.

(i) That such restriction has been expressly authorised and approved by the Central Government.

(j) That such restriction is necessary to meet the requirements of the defence of India or the security of the state.

(k) That the restriction is necessary to ensure the maintenance of essential goods and services.

Exemptions

The following restrictive trade practices are outside the purview of the MRTP Act:

(a) Those that take place in the State of Jammu & Kashmir;

(b) Unless the Central Government, by notification in the Official Gazettee, otherwise directs, the Act does not apply to public sector units and any trade union or other association of workmen or employees formed for their own reasonable protection as such workmen or employees;

(c) Restrictive trade practices to safeguard the rights of patentees under the Indian Patents Act in regard to certain infringements and in regard to the conditions they may lay down in the licences issued by them;

(d) Restrictive trade practices relating exclusively to the production, supply, distribution or control of goods for export;

(e) Restrictive trade practices as a result of any agreement between buyers relating to goods bought by them for consumption and not for resale whether in the same or different form or type or as constituents of some other goods;

(f) Those expressly authorised by any law.

Contol of Unfair Trade Practice

An unfair trade practice is a trade practice which, for the purpose of promoting the sale, use or supply of any goods or the provision of any services, adopts one or more unfair trade practices (like misleading advertisements) and thereby causes loss or injury to the consumers of such goods or services, whether by eliminating or restricting competition or otherwise.

The provisions to control unfair trade practices* have been incorporated into the Act by the MRTP (Amendment) Act, 1984.

The MRTP Commission may inquire into any unfair trade practice which may come before it for inquiry, and if, after such inquiry, it is of the opinion that the practice is prejudicial to the public interest, or to the interest of any consumer or consumers generally, it may, by order, direct that:

(a) The practice shall be discountinued or shall not be repeated;

---

* For details about the unfair trade practices, see the *Appendix* 16.1.

(b) Any agreement relating to such unfair trade practice shall be void or shall stand modified in respect thereof in such manner as may be specified in the order.

The Commission may, instead of making any order as mentioned above, permit any party to carry on any trade practice, if it so applies and takes such steps within the time specified by the Commission as may be necessary to ensure that the trade practice is no longer prejudicial to the public interest or to the interest of any consumer or consumers generally, and, in any such case, if the Commission is satisfied that the necessary steps have been taken within the time so specified, it may decide not to make any order as mentioned above in respect of that trade practice.

If any person contravenes the order made by the Commission in respect of unfair trade practices, he shall be punishable with imprisonment for a term which may extend to three years, or with fine which may extend to Rs. 10,000, or with both.

The Act also empowers the Commission to make any undertaking or person to pay compensation to the party who suffered a loss or damage as a result of the unfair trade practice carried on by the undertaking or person.

APPENDIX 20.1

UNFAIR TRADE PRACTICES

According to Part B, Chapter V of the MRTP Act, unless the context otherwise requires, "unfair trade practice" means a trade practice which, for the purpose of promoting the sale, use or supply of any goods or for the provision of any services, adopts one or more of the following practices and thereby causes loss or injury to the consumers of such goods or services, whether by eliminating or restricting competition or otherwise, namely:

(1) The practice of making any statement, whether orally or in writing or by visible representation, which :

- (i) falsely represents that the goods are of a particular standard, quality or grade;
- (ii) falsely represents that the services are of a particular standard, quality or grade;
- (iii) falsely represents any re-built, second-hand, renovated, reconditioned or old goods as new goods;
- (iv) represents that the goods or services have sponsorship, approval, performance, characteristics, accessories, uses or benefits which such goods or services do not have;
- (v) represents that the seller or the supplier has a sponsorship or approval or affiliation which such seller or supplier does not have;
- (vi) makes a false or misleadading representation concerning the need for, or the usefulness of any, goods or services;
- (vii) gives to the public any warranty or guarantee of the performance, efficacy or length of life of a product or of any goods that is not based on an adequate or proper test thereof;

Provided that where a defence is raised to the effect that such warranty or guarantee is based on adequate or proper test, the burden of proof of such defence shall lie on the person raising such defence;

(viii) makes to the public a representation in a form that purports to be—

(a) a warranty or guarantee of a product or of any goods or services; or

(b) a promise to replace, maintain or repair, an article or any part thereof or to repeat or continue a service until it has achieved a specified result,

if such purported warranty or guarantee or promise is materially misleading or if there is no reasonable prospect that such warranty, guarantee or promise will be carried out;

(ix) materially misleads the public concerning the price at which a product or like products or goods or services, have been, or are, ordinarily sold or provided, and, for this purpose, a representation as to price shall be deemed to refer to the price at which the products or goods or services has or have been sold by sellers or provided by suppliers generally in the relevant market, unless it is clearly specified to be the price at which the product has been sold or services have been provided by the person by whom or on whose behalf the representation is made;

(x) gives false or misleading facts disparaging the goods, services or trade of another person.

Explanation: For the purpose of clause (1) a statement that is:

(a) expressed on an article offered or displayed for sale, or on its wrapper or container; or

(b) expressed on anything attached to, inserted in, or accompanying, an article offered or displayed for sale, or on anything on which the article is mounted for display or sale; or

(c) contained in or on anything that is sold, sent, delivered, transmitted or in any other manner whatsoever made available to a member of the public;

shall be deemed to be a statement made to the public by, and only by, the person who had caused the statement to be so expressed, made or contained.

(2) permits the publication of any advertisement, whether in any newspaper or otherwise, for the sale or supply at a bargain price of goods or services that are not intended to be offered for sale or supply at the bargain price, or for a period that is, and in quantities that are, reasonable, having regard to the nature of market in which the business is carried on, the nature and size of business, and the nature of the advertisement.

Explanation: For the purpose of clause (2) "bargain price" means :

(a) a price that is stated in any advertisement to be a bargain price, by reference to an ordinary price or otherwise; or

(b) a price that a person who reads, hears, or sees the advertisement, would reasonably understand to be a bargain price, having regard to the price at which the product advertised or like products are ordinarily sold;

(3) permits —

(a) the offering of gifts, prizes or other items with the intention of not providing them as offered or creating the impression that something is being given or offered free of charge when it is fully or partly covered by the amount charged in the transaction as a whole;

(b) the conduct of any contest, lottery, game of chance or skill, for the purpose of promoting, directly or indirectly, the sale, use or supply of any product or any business interest;

(4) permits the sale or supply of goods intended to be used, or are of a kind likely to be used, by consumers, knowing or having reason to believe that the goods do not comply with the standards prescribed by the competent authority relating to performance, composition, contents, design, constructions, finishing or packaging as are necessary to prevent or reduce the risk of injury to the person using the goods;

(5) permits the holding or destruction of goods, or refuses to sell the goods or to make them available for sale, or to provide any service, if such hoarding or destruction or refusal raise or tends to raise or is intended to raise, the cost of those or other similar goods or services.

36B. The Commission may inquire into any unfair trade practice —

(a) upon receiving a complaint of facts which constitutes such practice from any trade or consumers' association having a membership of not less than twenty-five persons or from twenty-five or more consumers; or

(b) upon a reference made to it by the Central Government or a State Government;

(c) upon an application made to it by the Director-General; or

(d) upon its own knowledge or information.

36C. In respect of any unfair trade practice of which a complaint is made under clause (a) of Section 36B, the Commission shall, before issuing any process requiring the attendance of the person complained against, cause a preliminary investigation to be made by the Director-General, in such manner as it may direct, for the purpose of satisfying itself that the complaint requires to be inquired into.

36D. (1) The Commission may inquire into any unfair trade practice which may come before it for inquiry and, if, after such inquiry, it is of the opinion that the practice is prejudicial to the public interest, or to the interest of any consumer or consumers generally, it may by order, direct that —

(a) the practice shall be discontinued or shall not be repeated; and

(b) any agreement relating to such unfair trade practice shall be void or shall stand modified in respect thereof in such manner as may be specified in the order.

(2) The Commission may, instead of making any order under this section, permit any party to carry on any trade practice, if it so applies and takes such steps within the time specified by the Commission as may be necessary to ensure that the trade practice is no longer prejudicial to the public interest or to the interest of any consumer or consumers generally, and, in any such case, if the Commission is satisfied that necessary steps have been taken within the time so specified, it may decide not to make an order under this section in respect of that practice.

(3) No order shall be made under sub-section (1) in respect of any trade practice which is expressly authorised by any law for the time being in force.

36E. Without prejudice to the provisions of Section 12A, Section 12B and Section 36D, the Commission, the Director-General, may exercise, or perform, in relation to any unfair trade practice, the same power or duty which it or he is empowered, or required by or under this Act to exercise, or perform, in relation to a restricted trade practice.

APPENDIX 18.2

AGREEMENTS RELATING TO RESTRICTIVE TRADE PRACTICES SUBJECT TO REGISTRATION UNDER M.R.T.P. ACT

The MRTP Act provides that any agreement relating to a restrictive trade practice falling within one or more of the following categories shall be subject to registration as per the provisions of the Act.

(a) Any agreement which restricts, or is likely to restrict, by any method, persons or classes of persons to whom goods are sold or from whom goods are bought;

(b) Any agreement requiring a purchaser of goods, as a condition of such purchase, to purchase some other goods;

(c) Any agreement restricting in any manner the purchaser in the course of his trade from acquiring or otherwise dealing in any goods other than those of the seller or any other person;

(d) Any agreement to purchase or sell goods or to tender for the sale or purchase of goods only at prices or on terms or conditions agreed upon between the sellers and purchasers;

(e) Any agreement to grant or allow concessions or benefits, including allowances, discounts, rebates or credit in connection with, or by reason of, dealings;

(f) Any agreement to sell goods on condition that the price to be charged on resale by the purchaser shall be the price stipulated by the seller unless it is clearly stated that prices lower than those prices may be charged;

(g) Any agreement to limit, restrict, or without the output or supply of any goods or allocate any area or market for the disposal of the goods;

(h) Any agreement not to employ or restrict the employment of any method, machinery or process in the manufacture of goods;

(i) Any agreement for the exclusion from any trade association of any person carrying on, or intending to carry on, in good faith the trade in relation to which the trade association has been formed;

(j) Any agreement to sell goods at such prices as would have the effect of eliminating competition or a competitor;

(ja) Any agreement restricting in any manner, the class or number of wholesalers, producers or suppliers from whom any goods may be bought.

(jb) Any agreement as the bids which any of the parties thereto may offer at an auction for the sale of goods or any agreement whereby any party thereto agree to abstain from biding at any auction for the sale of goods.

(k) Any agreement not hereinbefore referred to in this section which the Central Government may, by notification in the official gazette, specify for the time being as being one relating to restrictive trade practice within the meaning of this subsection pursuant to any recommendation made by the Commission in this behalf;

(l) Any agreement to enforce the carrying out of any such agreement as is referred to above.

The provisions of this section shall apply, so far as may be, to agreements making provisions for services as they apply to agreements connected with the production, supply, distribution or control of goods.

However, no agreement within this section shall be subject to registration in accordance with the provisions of this chapter if it has been expressly authorised by or under any law for the time being in force or has the approval of the Central Government or if the government is a party to such agreement.

19

Company Law in India

Brief History of Company Law in India*

Indian Company Law has a long history. The Companies Act, 1956, is the successor to the Indian Companies Act of 1913 and is a consolidation of many successive Amendment Acts, statutory rules and principles laid down in decisions of the courts in India and in England. Several Acts were passed from 1850 onwards. The first Act, passed in 1850, was known as the Joint Stock Companies Act. This was followed by two Acts of 1857 and 1860; but the Act of 1866, which followed soon after, repealed all the previous enactments; and this Act itself was repealed in turn by the Act of 1882. This last-mentioned Act remained on the statute book up to 1913, though, in the meantime, it was amended several times to meet the demands of the commercial world. The Indian Companies Act of 1913 was passed with the object of consolidating and amending the law relating to trading companies, and was mainly based upon the English Companies Act of 1908, with certain additional provisions to meet the peculiar business conditions obtaining in this country. Since the Indian Act closely followed the English Company Law, the decisions of the English courts under the latter were also generally followed by the courts in India. This Act of 1913, however, did not provide for certain peculiarities of the Indian commercial world, such as the managing agency, and was, therefore, found to be highly unsatisfactory in several respects in the course of its working. Eventually, extensive amendments were introduced in the Act by the Indian Companies (Amendment)Act of 1935, which came into operation on 15th January 1937. The vast number of amendments introduced by this Act of 1937, however, involved a few omissions; but they were sought to be removed by frequent amendments in the subsequent years.

---

* Adapted from the *Report of High-Powered Expert Committee on Companies and MRTP Acts*.

The Act of 1913 was, however, repealed by the present Companies Act (1 of 1956) which was brought into force from 1st April 1956. This followed the acceptance by the Government of the recommendations of what is known as the Bhabha Committee which consisted of some Members of Parliament. This Committee submitted a detailed report in 1952, and a Bill incorporating the amendments suggested by it was introduced in the Lok Sabha in 1953 and became subsequently Act 1 of 1956. This Act, while adopting the scheme and most of the provisons of the UK Companies Act of 1948, marked a distinct improvement on the Act of 1913 in several respects and sought to ensure an efficient and honest management of companies governed by the Act.

Objectives of the Companies Act

The Companies Act, 1956, for the first time also provided for a greater measure of Governmental control over the formation and management of joint stock companies. This was considered desirable in the public interest and in order to prevent the diversion of company's funds for purpose which thwarted national economic policies or approved economic objectives.

The basic objectives underlying the law were to provide:

(i) a minimum standard of good behaviour and business honesty in company promotion and management;

(ii) due recognition of the legitimate interest of shareholders and creditors and of the duty of managements not to prejudice to jeopardise those interests;

(iii) provision for greater and effective control over and voice in the management for shareholders;

(iv) a fair and true disclosure of the affairs of companies in their annual published balance sheet and profit and loss accounts;

(v) a higher standard of accounting and auditing;

(vi) recognition of the rights of shareholders to receive reasonable information and facilities for exercising an intelligent judgement with reference to the management;

(vii) a ceiling on the share of profits payable to managements as remuneration for services rendered;

(viii) a check on their transactions where there was a possibility of conflict of duty and interest;

(ix) a provision for investigation into the affairs of any company managed in a manner oppressive to a minority of the shareholders or prejudicial to the interest of the company as a whole; and

(x) enforcement of the performance of their duties by those engaged in the management of public companies or of private companies which were subsidiaries of public companies by providing sanctions in the case of breach and subjecting the latter also to the more restrictive provisions of law applicable to public companies.

Meaning of Company

In the words of Lord Justice Lindley, "a company is an association of many persons who contribute money or money's worth to a common stock and employ it in some trade or business, and who share the profit and loss arising therefrom. The common stock so contributed is denoted in money and is the capital of the company. The persons who contribute to it or to whom it belongs are members. The proportion of capital to which each member is entitled is his share. The shares are always transferable although the right to transfer is often more or less restricted." According to Chief Justice Marshall, "a corporation is an artificial being, invisible, intangible, existing only in contemplation of the law. Being a mere creation of law, it possesses only the properties which the charter of its creation confers upon it, either expressly or as incidental to its very existence." Hahlo's *Case Book on Company Law* says that "like any juristic person, a company is legally an entity apart from its members, capable of rights and duties of its own, and endowed with the potential of perpetual succession."

Section 3 (1)(i) of the Companies Act says that " a company means a company formed and registered under this Act or an existing company." Section 3(1)(ii) lays down that an existing company is a company formed and registered under any of the previous company laws.

Classifications of Companies

In the Companies Act, companies are classified as under:

(a) Companies limited by shares (sub-divided into public, deemed public and private companies);

(b) Companies limited by guarantee (either with or withsout share capital); and

(c) Companies with unlimited liability (either with or without share capital).

The Companies Act also mentions three special types of companies, namely:

(i) Holding and subsidiary companies;

(ii) Government companies; and

(iii) Investment companies.

Unlimited Companies

A company not having any limit on the liability of its members is termed an unlimited company. The members of an unlimited company are liable, like the partners of a firm, for all its trade debts without any limit.

An unlimited company must have Articles of Association, stating the number of members with which the company is to be registered. An unlimited company may or may not have share capital. If it has share capital, the Articles of Association shall also state the amount of share capital with which it is to be registered.

The High-Powered Expert Committee on Companies and MRTP Acts, popularly known as the Sachar Committee, observes that "although the present Act provides for the formation of unlimited companies, the latter have hardly had any useful career in the growth and development of the corporate sector. We feel that the concept of a company with unlimited liability of its members does not conform to the corporate concept which necessarily postulates a limited liability. We, therefore, suggest that this type of companies should be abolished from the statue book....It is also suggested that the existing unlimited companies should be compulsorily required to convert themselves into limited companies. For this purpose, the total assets of an unlimited company, as reduced by its outside liability, should be taken as the capital which should be deemed to be paid up and the company concerned should be made to file an annual return, on that basis, within a period of six months from the commencement of the new Act."[1]

As on 31st March, 1994, there were 349 companies with unlimited liabilities.

Guarantee Companies

The liability of the members of a guarantee company is limited by a fixed sum which is specified in the memorandum and beyond which they cannot be called upon to contribute. The memorandum of a company limited by guarantee shall state that each member undertakes to contribute to the assets of the company, in the event of its being wound up for the payment of the debts and liabilities of a company, such amount as may be required, not exceeding a specific amount. A company limited by guarantee may or may not have share capital.

The Sachar Committee observes that "although guarantee companies...constitute a very negligible fraction of less than three per cent of the total companies...at work in India, they still do have a useful role to play as companies for furthering the objects of usually such a company does not apply its profits or rather income except for these desirable objectives. It is, however, inherent in the very nature of these objectives that such companies be formed as public limited companies, limited by guarantee only and for the purpose enumerated in the present Section 25 of the Act. As regards the existing guarantee companies, which numbered 1,381 as on 31st March, 1978, the Central Government should be empowered to issue any·directive for either getting themselves registered under the provisions corresponding to the present Section 25 of the Act or converting themselves into companies limited by shares".[2]

As on 31st March, 1994, the number of companies limited by guarantees and associations not for profit was 2,350.

Limited Companies

In case of a limited company, the liability of its members is restricted to the amount of share capital subscribed by them or standing in their names, should at any time the company be wound up and the value of its assets be insufficient to meet its liabilities. The companies falling under this category are required by law to add the word "Limited" at the end of their names.

The two important kinds of limited companies are the public limited company and the private limited company.

*(a) **Public Company:*** A public limited company may be formed by a minimum of 7 subscribers. There is no maximum limit to the number of shareholders that a public company can have. A foreign national or a non-resident may also be a shareholder with the approval of the Reserve Bank of India.

As the public companies have a wide membership, control and operate substantial financial resources, and cover fields of activities affecting not only the member-creditors but also the public generally, a number of regulatory provisions have been made under the company law to exercise control on the working of these companies.

As on March 31, 1994, there were 38,000 public limited companies in India with a total paid-up capital of Rs. 70,112.1 crores. 590 of them were government companies with a paid up capital of Rs. 36,761.4 crores.

*(b) **Private Company:*** A private limited company may be formed by a minimum of two members. Its total membership, however, cannot exceed 50 persons. Its shares cannot be transferred freely, and such a company is also prohibited from inviting the public to subscribe to its shares or debentrues.

Private companies are, however, not subject to all the regulatory provisions that are applicable to public companies. In the case of a private company, prospectus or a statement in lieu of prospectus is not required to be issued. Provisions relating to the manner of increasing the subscribed capital of the company, the restrictions on the appointment of Directors, and provisions relating to statutory meetings and statutory reports do not apply to them. A private company may commence business on registration by the Registrar without having to obtain a certificate for commencing business.

At the end of March, 1993, there were 241,552private limited companies in India with a total paid-up capital of Rs. 35,316.4 crores. 627 of them were government companies with a paid-up capital of Rs. 30,166.9 crores.

Conversion of Private Company into Public Company

A private company becomes a public company in the following cases:

(i) If not less than 25 per cent of the paid-up share capital of a private company is held by one or more bodies corporate, the company shall become a public company.

(ii) If the average annual turnover of a private company at any time is not less than such amount as may be prescribed (now Rs. 5 crores) for three consecutive financial years, the company shall become a public company.

(iii) If a private company holds not less than 25 per cent of the paid-up capital of a public company having share capital, the private company shall become a public company.

(iv) If a private company so alters its Articles that they do not contain the provisions which make it a private company, it ceases to be a private company as on the date of the alteration. It must then file with the Registrar, within thirty days, either a prospectus or a statement in lieu of a prospectus. When this is done, the company becomes a public company.

(v) If a private company accepts, after advertisement, or renews deposits from the public other than its members, directors or their relatives (Added by the amendment of 1988).

Where the private company becomes a public company, the articles of association may include the following provisions :

(i) Restrict the right to transfer its shares;

(ii) Limit the number of its shares to fifty, not including :

  (a) persons who are in the employment of the company;

  (b) persons who, having been formerly in the employment of the company, were members of the company while in that employment and have continued to be members after the employment has ceased; and

  (c) prohibits any invitation to the public to subscribe for any shares in or debentures of the company.

If two or more persons hold one or more shares in a company jointly, they shall for the purposes of this definition be treated as a singel member.

Within three months from the date on which a private company becomes a public company, the company shall inform the Registrar that it has become a public company, and the Registrar will then delete the word "Private" before the word "Limited" in the name of the company and will also make the necessary alterations in the certificate of incorporation issued to the company and in its Memorandum of Association.

Government Company

Government companies, as a separate class of companies, were recognised for the first time in the Companies Act, 1956. Though the number of Government companies is comparatively small when compared to the number of non-Government companies, they account for nearly three-fourths of the paid-up capital of all the companies operating in India.

The Companies Act defines a Government company as a company in which not less than fifty-one per cent of the paid-up share capital is held by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments, and includes a company which is a subsidiary of a Government company thus defined.

Section 620 of the Companies Act empowers the Central Government to exempt the Government companies from many of the provisions of the Act. The Sachar Committee has remarked that, "keeping in view the recommendations for simplification of the Company Law, there will be no case for Government companies claiming exemption from the provisions of the law."[3]

As at the end of March, 1994, there were 1,203 Government companies in India with a total paid up capital of Rs. 64,027.5 crores.

Holding and Subsidiary Companies

When a company has control over another, it is known as a holding company, and the company so controlled is regarded as a subsidiary company.

A company shall be deemed to be the holding company of another, if, but only if, the other is its subsidiary.

A company shall be deemed to a subsidiary company in any one or more of the following cases :

(i) Where one company controls the composition of the Board of Directors of another, the latter becomes a subsidiary of the former;

(ii) Where one company holds a majority of the shares in another company, the latter becomes a subsidiary of the former;

(iii) Where one company is a subsidiary of another, which is itself a subsidiary of some other company, the first-mentioned company shall also become the subsidiary of the last-mentioned company.

Investment Company

An investment company is described as a company whose principal business is the acquisition of shares, debentures or other securities. In order to prevent investment companies from functioning as catalysts of corporate control, the Sachar Committee has recommended a modification of definition of the investment company to exclude private companies and to include only those public companies which are carrying on business of only underwriting or dealing in shares, debentures or other securities.

---

[3] *Ibid.*, p. 225.

Foreign Company

The term *foreign company* means a company incorporated outside India, but has a place of business in India. The Companies Act requires that, within 30 days of the establishment of business in India, the company should submit the following documents to the Registrar at New Delhi and the State of its location:

(i) A certified copy of its Memorandum of Articles or other instrument of its incorporation·

(ii) The full address of the registered office abroad;

(iii) The names, etc., of its directors, secretary, persons in India authorised to accept documents in India; and

(iv) The full address of its principal place of business in India.

The Companies (Amendment) Act of 1974 provides that if not less than 50 per cent of the paid-up share capital, whether preference or equity, is in Indian hands, the provisions of the Act as a whole shall apply to such a foreign company as if it were incorporated in India. The Amendment Act of 1974 has also extended the provisions of the Act, in respect of certain matters, to all foreign companies. Foreign companies are now required to file an annual return with the Registrar, besides being subjected to the provisions relating to the maintenance of accounts, cost audit and special audit, and in respect of investigation, etc.

The Sachar Committee remarks : "In our view, the present position with regard to foreign companies...is rather unsatisfactory. We are particularly against the practice of first allowing certain bodies corporate incorporated outside India to be registered as foreign companies and then apply a large number of sections in the Act, not otherwise applicable to them by making indirect provisions here and there from time to time. Instead, it would be desirable to lay down certain conditions under which all bodies corporate desirous of establishing a place of business in India must necessarily subject themselves to the discipline of the law of this country by following the normal procedure of registration and incorporation under the law of the land".[4]

As on March 31, 1994, there were 565 foreign companies in India.

FORMATION OF COMPANIES

The formal steps involved in the formation of a company include finding a suitable name for the company, determining the location of the registered office of the company, drawing up the Memorandum of Association and Articles of Association, submitting the necessary documents to the Registrar of Companies, and finally getting the company registered with him. Once a company is registered, it emerges as a legal entity.

---

[4] *Ibid.*, p. 26.

Name of the Company

The name of the company must be stated in its memorandum, with the company's seal, on its business letters, negotiable instruments and orders for money and goods. The name must also be affixed outside every office or place in which the business is carried on. In the case of private companies, the word 'Private' should also be used with the name of the company.

A company cannot be given a name which, in the opinion of the Central Government, is undesirable or identical with, or closely resembles, the name of an existing company. The Registrar of Companies maintain up-to-date lists of the names of all the companies in India.

Memorandum of Association

The promoters of a company are required to draw up a Memorandum of Association. The Memorandum of Association is regarded as the *fundamental* document of the company because it contains "the fundamental conditions upon which alone the company is allowed to be incorporated". It is the charter of the company, defining the object of its formation and its operations, and its purpose is to inform its shareholders, creditors and others dealing with it of its permitted range of enterprise. It is *ultra vires* for a company to act beyond the scope of its memorandum, and any departure is invalid and cannot be validated even if assented to by all the members of the company.

The promoters of the company shall subscribe their names to the Memorandum. If a private company is to be formed, then two or more persons may subscribe to the memorandum; but if a public limited company is to be formed, at least seven persons should sign the memorandum.

The memorandum of *every company* is required to state :

(i) The name of the company with "Limited" as the last word of the name in the case of a public limited company, and with "Private Limited" as the last words of the name in the case of a private limited company;

(ii) The State in India in which the registered office of the company is to be situated;

(iii) In the case of a company in existence immediately before the commencement of the Companies (Amendment) Act, 1956, the object of the company;

(iv) In the case of a company formed after such commencement;

(a) **The main objects of the company to be pursued by the company on its incorporation and objects incidental** or ancillary to the attainment of the main objects; and

(b) Other objects of the company not included under (a) above ; and

(v) In the case of companies (other than a trading corporation), with objects not confined to one State, the States to whose territories the objects extend.

The memorandum of a *company limited by shares* shall also state that the liability of its members is limited.

The memorandum of a *company limited by guarantee* shall also state that each member undertakes to contribute to the assets of the company in the event of its being wound up while he is a member, or within one year after he ceases to be a member, for the payment of the debts and liabilities of the company, or of such debts and liabilities of the company as may have been contracted before he ceases to be a member, as the case many be, and of the costs, charges and expenses of winding up, and for the adjustment of the rights of the contributors among themselves, such amount as may be required not exceeding a specified amount.

In the case of a *company having share capital;*

(i) Unless the company is an unlimited company, the memorandum shall also state the amount of the share capital with which the company is to be registered and the division thereof into shares of a fixed amount;

(ii) No subscriber of the memorandum shall take less than one share; and

(iii) Each subscriber of the memorandum shall write opposite to his name the number of shares he takes.

The memorandum of association of a company shall be in one of the Forms in Tables B, C, D and E in Schedule I to the Companies Act, 1956, which may be applicable to the case of the company, or in a Form as near thereto as circumstances admit.

Articles of Association

The Articles of Association are the rules, regulations and bye-laws for the *internal* management of the affairs of a company. They are framed with the object of carrying out the aims and objects as set out in the Memorandum of Association.

The Articles usually contain provisions relating to such matters as share capital; rights of shareholders and variation of these rights; lien on shares; calls on shares; transfer of shares; conversion of shares into stock; alteration of capital; general meetings and proceedings thereat; voting rights of members, voting and poll, proxies; directors, their appointments, remuneration, qualifications, powers and proceedings; Board of Directors; and so on.

The provisions of the Articles must be in conformity with the Memorandum and the provisions of the Companies Act.

A company may, by passing a special resolution, alter the regulations contained in its Articles any time, and adopt any new regulations which might have been lawfully included in the original Articles.

A public company may have its own Articles of Association; however, this is not essential. If it does not have its own Articles, it may adopt Table A given in Schedule I to the Act.

The articles of association of a private company, which must be registered with the Registrar of Companies, must contain the following distinguishing features:

(i) A clause restricting the right to transfer its shares;

(ii) A clause limiting the number of its members to fifty (excluding those who are or were employees in the company at the time of the acquisition of the shares), two or more persons holding shares jointly being accounted as a single member; and

(iii) A clause prohibiting any invitation by the company to the public to subscribe to any shares or debentures of the company.

The absence of any one of these three restrictive provisions or a failure to conform to them would result in the company losing the privileges and exemptions attached to a private company. However, courts of law may, after due enquiry, condone such lapses in specific cases.

According to the Companies Act, a company in any of the following category, viz., unlimited companies, companies limited by guarantees and private companies limited by shares, must have its own Articles.

Schedule I to the Companies Act gives various model forms of Memorandum of Association and Articles of Association of various types of companies.

Registration of the Company

The Memorandum of Association and the Articles of Association, if any, have to be submitted to the Registrar of Companies of the State in which it is proposed to locate the registered office of the company. Both the Memorandum and the Articles of Association should be duly stamped, the rate of stamp duty varying from State to State. In addition to the stamp duty, the registration fee should be paid at the time of registration.

The following documents should be submitted along with the Memorandum and Articles of Association:

(i) Form 1—Declaration of compliance with the requirements of the Companies Act, 1956. The declaration should be in the prescribed form and be made on non-judicial stamp paper.

(ii) Form 10 — Notice of situation/Change of situation of the Registered Office.

(iii) Form 32 — Appointment of Directors.

(iv) Form 29 — Consent to act as a Director.

After the Registrar has verified the documents and is satisfied that they are in order, he will certify under his hand that the company is incorporated; in the case of a limited company, he will further certify that it is a limited company.

Prospectus

The Companies Act defines a prospectus as "any document described or issued as prospectus and includes any notice, circular, advertisement or other document inviting deposits from the public or inviting offers from the public for the subscription or purchase of any shares in, or debentures of, a body corporate.

Before the allotment of shares, a public company shall file with the Registrar either the prospectus or a statement in lieu of the prospectus. The company can issue the prospectus only if it has been filed, and proceed to allot shares only after the minimum subscription specified in the prospectus has been collected. (It may be recalled here that, according to the Companies Act, a private company is prohibited from making any invitation to the public to subscribe to any shares in, or debentures of, the company. Hence a private company need not issue a prospectus.)

The prospectus, which aims at persuading the public to purchase the securities of the company, describes the prospects and advantages likely to accrue to the holders of the securities of the company, and sets forth the particulars of the amount issued, the rights attached to the shares, the property purchased or agreed to be purchased by the company, the details of directors, managing directors, amount of minimum subscription to be received before allotment; names and address of auditors, bankers, solicitors, etc.

Certificate of Commencement of Business

In the case of a company issuing a prospectus, a certificate of commencement of business is issued by the Registrar after the filing of a declaration by a director or secretary stating that the company has collected the minimum subscription stated in the prospectus and that the directors have taken the qualification shares, if such qualification has been prescribed by the articles. If a company does not issue a prospectus, such a certificate will be issued when a declaration is filed to the effect that a statement in lieu of the prospectus has been filed and that the directors have taken the requisite qualification shares.

BOARD OF DIRECTORS

The company, being an artificial person, its activities have to be carried out by persons authorised for that purpose. It may be said that the ultimate power rests with the shareholders. However, the executive authority is usually exercised by the Board of Directors, most of whom are normally elected by the shareholders.

According to the Companies Act, every company must have a Board of Directors. The Board of a public limited company shall consist of not less than three and of any other company, including a deemed public limited company, not less than two directors. The Companies Act does not specify any upper limit for the number of directors. Subject to the minimum laid down by the Act, a company can vary the number of the directors with the consent of the general body meeting of the shareholders, subject to the upper limits set in the Articles of Association. However, a public limited company or a private limited company, which is a subsidiary of a public limited company, can increase the existing strength of the Board beyong the maximum of twelve only with the approval of the Central Government.

The Companies Act specifically states that no body corporate, association, or firm shall be appointed director of a company, and only an individual shall be so appointed.

In default of and subject to any regulations in the Articles of a company, subscribers of the Memorandum who are individuals shall be deemed to be the directors of the company until the directors are duly appointed by the general meeting in accordance with the Companies Act.

According to the Act, unless the Articles of Association provide for the retirement of all the directors at every annual general meeting, not less than two-thirds of the total number of directors of a public company, or a private company which is a subsidiary of a public company, shall retire, and the vacancies created by such retirement shall be filled up by appointing the retiring directors or some other members by the company in the general meeting. The persons to retire at a point of time are determined by the length of service. As between persons who became directors on the same day, those who are to retire shall, in the absence of any agreement among themselves, be determined by lot. The company is required to inform the members about the candidature of a person for the office of a director or the intention of a member to propose such a person as a candidate for that office either by serving individual notices on the members or by advertising in at least two newspapers (one in English and the other in the regional language of the place where the registered office of the company is located) circulating in the place where the registered office of the company is located, not less than seven days in advance.

If the office of any director appointed by the company in the general meeting is vacated before his term of office expires in the normal course, the resulting vacancy may be filled by the Board of Directors at a meeting of the Board.

It shall be the duty of every director, who is required by the articles of the company to hold a specified share qualification and who is not already qualified in that respect, to obtain his qualification within two months after his appointment as director. The nominal value of the qualification share shall not exceed five thousand rupees, or the nominal value of one share where it exceeds five thousand rupees.

Disqualifications

A person shall not be capable of being appointed director of a company, if

(a) He has been found to be of unsound mind by a court of competent jurisdiction and the finding is in force;

(b) He is an undischarged insolvent;

(c) He has applied to be adjudicated as an insolvent and his application is pending;

(d) He has been convicted by a court of any offence involving moral turpitude and sentenced in respect thereof to imprisonment for not less than six months, and a period of five years has been elapsed from the date of expiry of the sentence;

(e) He has not paid any call in respect of the company shares held by him, whether alone or jointly with others, and six months have elapsed from the last day fixed for the payment of the call; or

(f) An order disqualifying him for appointment as director has been passed by a court in pursuance of Section 203 and is in force, unless the leave of the court has been obtained for his appointment in pursuance of that section.

A private company, which is not a subsidiary of a public company, may, by its articles, provide that a person shall be disqualified for appointment as a director on any grounds in addition to those specified above..

Vacation of Office

A person holding office as director will be deemed to have vacated his office if he:

(a) Fails to obtain or ceases to hold the share qualification, if any, prescribed by the articles;

(b) Having been appointed a director by virtue of his holding any office or other employment in the company, ceases to hold such office or other employment;

(c) Is removed in the general meeting;

(d) Fails to pay calls on the shares held by him within six months of the call;

(e) Absents himself from all meetings of the Board for a continuous period of three months or for a period covered by three consecutive meetings of the Board, whichever is longer, without obtaining leave of absence from the Board;

(f) Accepts, or allows another person on his account to accept, a loan or a guarantee or a security from the company except as permitted under the Act;

(g) Fails to disclose his interest in contracts entered into by or on behalf of the company;

(h) Is disqualified by a court consequent on conviction of an offence in connection with the formation or management of a company or for being guilty of fraud or misfeasance in relation to a company;

(i) Applies to be adjudicated an insolvent and such application is pending, or is adjudged insolvent;

(j) Is convicted of an offence involving moral turpitude and sentenced to imprisonment of more than six months; and

(k) Is declared to be of unsound mind by a court.

A director who so vacates his office is not entitled to any compensation for loss of office from the company.

Alternate Directors

The Board of Directors of a company may, if so authorised by its Articles or by a resolution passed by the company in a general meeting, appoint an *alternate director* to act for a director, called the *original director*, during the latter's absence for a period of not less than three months from the State in which the meetings of the Board are ordinarily held. An alternate director shall not hold office for a period longer than that permissible to the original director in whose place he has been appointed. The alternate director shall vacate the office if and when the original director returns to the State in which the meetings of the Board are ordinarily held.

Government Directors

The Companies Act empowers the Central Government to appoint any number of directors to the Board for any period not exceeding three years on any one occasion. Such appointment may be made by the Government *suo moto* or on the application of not less than one hundred members of the company or of the members of the company holding not less than one-tenth of the total voting power.

Nominees of Creditors

Under certain circumstances, the debenture-holders or other creditors like a banking company or financial corporation, who have advanced loans to the company may appoint their nominees to the Board. The number of directors so appointed shall not exceed one-third of the total number of directors, and they are not liable to retire by rotation.

Restriction on Number of Directorships

According to Section 275 of the Companies Act, no person shall hold office at the same time as director in more than twenty companies. However, in calculating the number of companies of which a person is director, the following companies are to be excluded:

(a) A private company which is neither a subsidiary nor a holding company of a public company;

(b) An unlimited company;

(c) An association not carrying on business for profit or which prohibits the payment of a dividend;

(d) A company in which such person is only an alternate director.

Meeting of the Board

According to Section 285 of the Act, a meeting of the Board of Directors must be held at least once in every three months and at least four such meetings shall be held in every year. However, the Central Government is empowered to relax Section 285 in relation to any class of companies. A written notice of such meetings should be given to every director in India, including the alternate directors. The quorum for a Board meeting is one-third of the total strength (a fraction in that one-third being counted as one), or two, whichever is higher. In calculating the quorum, the directors, directly or indirectly interested in the contract or arrangement, if any, under discusion at the meeting, should be excluded.

Powers of Directors

The powers of the Board of Directors may be broadly divided into:

(i) General powers; and

(ii) Powers to be exercised only at Board meetings.

(i) General Powers: Subject to the provisions of the Companies Act, the Board of Directors is entitled to exercise all such powers, and to do all such acts and things, as the company is authorised to exercise and do. This power, however, is subject to the following two conditions:

(a) The Board shall not exercise any power or do any act or thing which is to be exercised or done by the company in the general meeting.

(b) In exercising any such power or doing any such act or thing, the Board shall be subject to the provisions contained in that behalf in the Companies Act or any other Act, or in the memorandum or articles of the company, or in any regulations not inconsistent therewith and duly made thereunder, including regulations made by the company in a general meeting.

Further, no regulation made by the company in a general meeting shall invalidate any prior act of the Board which would have been valid if that regulation had not been made.

(ii) Powers to be Exercised by Board only at Meeting : The Board of Directors shall exercise the following powers on behalf of the company and shall do so only by means of resolutions passed at meetings of the Board ;

(a) The power to make calls on shareholders in respect of money unpaid on their shares;

(b) The power to issue debentures;

(c) The power to borrow moneys otherwise than on debentures;

(d) The power to invest the funds of the company; and

(e) The power to make loans.

The Board may, by a resolution passed at a meeting, delegate the last three powers to a Committee of Directors or the manager or any other principal officer of the company; but the Board shall specify the limits of such delegation.

Restriction on Powers

The Board of Directors of a public company, or of a private company which is a subsidiary of a public company, shall not exercise the following powers, except with the consent of the company in a general meeting:

(a) To sell, lease or otherwise dispose of the whole, or substantially the whole, of the undertaking of the company;

(b) To remit or give time for repayment of any debt due to the company by a director except in the case of renewal or continuance of an advance made by a banking company to its director in the ordinary course of business;

(c) To invest, otherwise than in trust securities, the amount of compensation received by the company in respect of the compulsory acquisition of any undertaking or property of the company;

(d) To borrow moneys where the moneys to be borrowed, together with the moneys already borrowed by the company (apart from temporary loans obtained from the company's bankers in the ordinary course of business), exceed the aggregate of the paid-up capital of the company and its free reserves;

(e) To contribute to charitable and other funds not directly related to the business of the company or the welfare of its employees, amounts exceeding in any financial year Rs. 50,000 or **5 per cent** of the average net profits of the three preceding financial years, whichever is greater [Section 293 (1)].

Section 293-A places a restriction on the powers of the Board of Directors to contribute any amount to any politcial party or for any political purpose to any individual or a body.

INTER-CORPORATE INVESTMENTS

Inter-corporate investments are regulated by Section 372 of the Companies Act. According to this section, the Board of Directors of a company is entitled ot invest in any shares of any other body corporate upto10 per cent of the subscribed capital of such other body corporate subject to the following conditions:

(i) The aggregate of the investments made by the Board in all other bodies corporate shall not exceed 30 per cent of the subscribed capital of the investing company;

(ii) The aggregate of the investments made in all other bodies corporate in the same group shall not exceed 20 per cent of the subscribed capital of the investing company. A body corporate is deemed to be in the same group as the investing company if the body corporate and the investing company are deemed to be under the same management.

Previous approval of the company in a general meeting and of the Central Government is required to be obtained before a company invests in the shares of another body corporate in excess of the limits specified above.

PROTECTION OF INVESTORS AND CREDITORS

The Companies Act contains a number of provisions safeguarding the interests of investors and creditors. Provisions in respect of a proper "disclosure" of the interests of managerial personnel in other companies, limits on managerial remuneration, special audits, inspection and investigation, regulation of appointment of sole-selling agents, protection of minority interests, appointment of government directors, removal of managerial personnel, reconstruction of the company, etc., seek to serve this purpose.

The Act empowers the Central Government to order a special audit of the accounts of a company for such period as may be specified by it, if, in its opinion:

(a) The affairs of the company are not being properly managed;

(b) The financial position of the company is not sound; or

(c) The affairs of the company are being managed in a manner likely to cause serious injury or damage to the interests of the trade or industry or business to which it pertains.

The Act also empowers the Registrar of Companies, or any officer authorised by the Central Government, to inspect, without previous notice, the books of account and other books and papers of a company, and enjoins on the company to give the Registrar or the authorised officer all reasonable assistance in the matter. Further, the Central Government is empowered to order an investigation into the affairs of a company at the instance of either the members of the company, or the Registrar of Companies, or *suo moto*.

To safeguard the interest of the company, or its shareholders or the public interest, the Central Government is empowered to appoint any number of directors to the Board for any period not exceeding three years on any one occasion. Such appointment may be made by the Central Government *suo moto*, or on the application of not less than one hundred members of the company, or of members of the company holding not less than one-tenth of the total voting power.

WINDING UP OF COMPANIES

A company registered under the Companies Act can cease to exist by any one of the following legal methods:

(i) If a company transfers its undertaking(s) to another company under a scheme of reconstruction or amalgamation, it may be dissolved without winding up, if the court so directs.

(ii) The name of a defunct company may be removed from the Register of Companies by the Registrar.

(iii) A company may be wound up under Part VII of the Companies Act.

Pennington defines winding up as a process by which the management of a company's affairs is taken out of its directors' hands, its assets are realised by a liquidator, and its debts are paid out of the proceeds of realisation, and any balance remaining returned to its members. At the end of the winding up, the company will have no assets or liabilities. It will, therefore, be only a formal step to have it dissolved, and bring to an end its legal personality as a corporation.

Voluntary Winding Up

Voluntary winding up may be:

(i) At the instance of the members or creditors; or

(ii) Under the supervision of the court.

A declaration of solvencey by the Board at its meeting is necessary for a voluntary winding up of a company by its members. An ordinary or special resolution, depending upon the case, is necessary for such voluntary winding up. An ordinary resolution is necessary when the period, if any, fixed for the dissolution of the company by the Articles has expired, or the event, on the happening of which the articles contemplated the company to be dissolved, has happened. In other cases a special resolution is required to be passed.

In cases of voluntary winding up at the instance of the members, the company may appoint a liquidator who assumes charge of the company and its affairs. As in winding up by a court, the persons in charge of the management of the company have to submit to the liquidator a statement on its assets and liabilities the names of its creditors and debtors, and other particulars. After the affairs of the company are fully wound up, the liquidator has to call a final meeting of the company and place before it the final accounts.

Voluntary winding up by the creditors may be resorted to when there is no declaration of solvency by the Board of Directors. Besides the resolution passed at a general meeting of the company, a duly convened creditors' meeting should endorse the decision. The creditors' nominee would be the liquidator in case there is disagreement on the choice of the liquidator between the creditors and the company.

At any time after a company has passed a resolution for voluntary winding up, the court may make an order that the voluntary winding up shall continue, but subject to such supervision of the court, and with such liberty for the creditors, contributories or others to apply to the Court, and generally on such terms and conditions, as the court thinks just. A petition for the continuance of a voluntary winding up, subejct to the supervision of the court, shall, for the purpose of giving jurisdiction to the court over suits and legal proceedings, be deemed to be a petition for winding up by the court.

There are two principal modes of winding up a company, viz.,

(i) Winding up by the court; and

(ii) Voluntary winding up.

Compulsory Winding Up

A company may be wound up by the court,

(a) If the company has, by *special resolution*, resolved that it be wound up by the court;

(b) If *default* is made in *delivering the statutory report* to the Registrar or in holding the statutory meeting;

(c) If the company *does not* commence its business *within a year* from its incorporation, or suspends, its business for a whole year;

(d) If the number of *members is reduced*, in the case of a public company, below seven, and in the case of a private company, below two;

(f) If the Court is of the opinion that it is *just and equitable* that the company should be wound up.

The Act contains provisions for the appointment of an official liquidator to each High Court. In the case of winding up by the court, the official liquidator becomes the liquidator of the company on a winding up order being made.

COMPANY LAW ADMINISTRATION

There is a three-tier administrative machinery for the administration of company law. At the top is the Company Law Board charged with the overall responsibility for company law administration. It ensures administrative coordination with other related statutes concerning corporate enterprises.

The *Company Law Board* (*CLB*) shall consist of not more than nine members. The actual number of the members of the Board at any time is decided by the government. Presently there are six members.

Certain powers which, prior to the Companies Amendment Act, 1974, were with the court, have by this Act, been given to the Company Law Board. These relate to

(i) Alteration in the memorandum of the company;

(ii) Power to authorise issue of shares at a discount;

(iii) Power to order a general meeting; and

(iv) Power to accord approval wherever it is required under the provisions of the Act.

It has been reported that there is a proposal to turn the quasi-judicial Company Law Board into the sole arbiter of the destinies of the private sector.

Next to the Company Law Board are four Regional Directors at Calcutta, Bombay, Madras and Kanpur. Below the Regional Directors there are the Registrars.

In all the State capitals, there is now a Registrar of Companies with whom companies can be registered. The Registrars have the following three important functions:

(a) They collect and serve the vital documents relating to all companies in their respective States. These documents are available for inspection by members as well as by non-members of the company.

(b) They encourage the proper functioning of the company by the requirement of punctual submission of reports and returns by all companies.

(c) They scrutinise the contents of the returns to determine whether they have complied with the law. If the Registrars suspect anything wrong with the affairs of a company, they can call for further information and explanation from the company, consult the Regional Directors, or refer the matter to the Company Law Board for the purpose of investigation by Inspectors.

The Regional Directors form a link between the Regisrars and the Central Government as well as between the Central Government and the State Governments, and they keep the Company Law Board informed of all relevant matters.

Keeping in view the recommendation of the Sachar Committee and as conceived by the 1988 Amendment to the Companies Act, the CLB is made independent of the Department of Company Affairs since May 31, 1991.

The CLB which has been given more teeth now is a quasi-judicial body to exercise some of the judicial and quasi-judicial functions which were exercised earlier either by the court or the Central Government. The orders of the Board will be appellable to High Court on questions of law.

20

Price and Distribution Controls

Control over price and distribution has come to stay as one of the important means of achieving the socio-economic goals in many planned, especially developing, economies. The important factors that call for price and distribution controls in countries like India are short supply of goods and services, an unreasonable level of prices in the free market and the very low levels of income of a large number of people.

Objectives of Price and Distribution Controls

The obectives of price and distribution controls in general are to supplement the efforts of other instruments of planning. The specific objectives of the control over price and distribution may be listed as follows :

(i) Equity or Distributive Justice : Growth with social justice has been accepted as a major objective of development. This implies that the fruits of development should be distributed equitably. But it has been generally accepted that inflation distorts income distribution against the poor. Many a time, the scarcity of "wage goods"— the essential consumer items— leads to blackmarketing, making the life of the poor more miserable. One of the prime objectives of price and distribution controls, therefore, is to protect the vulnerable sections against inflation and shortages, and ensure a reasonable level of consumption for them.

(ii) Maintain Quality of Goods and Services : Price and distribution controls aim at ensuring the quality of goods and services. For instance, the Industries (Development and Regulation) Act, 1951, the Essential Commodities Act, 1955, etc., empower the Government of India to control the quality of various goods and services.

(iii) Prevention of Monopolistic, Restrictive and Unfair Trade Practices : Prevention of certain trade practices that are detrimental to the common interest is another major objective of price and distribution controls. In India, the MRTP Act, 1969, seeks to prevent the monopolistic, restrictive and unfair trade practices that are prejudicial to the public interest. This Act,

apart from trying to remove certain imperfections in supply, also aims at ensuring that capital investment and technical development are not hampered by such trade practices.

(iv) Augment Supply : Increasing the supply of goods and services is of paramount importance to reduce the hardships of the people by making goods available at reasonable prices. And this is one of the objectives of the price and distribution controls. The Industries (Development and Regulation) Act, the Essential Commodities Act, and the MRTP Act contain provisions to prevent unjustifiable reduction in production by industrial undertakings. The public distribution system of the Government of India envisages a comprehensive production-cum-distribution scheme.

(v) Enlarge and Smoothen the Supply System : To remove the imperfections in the supply system in order to ensure the availability of essential goods at reasonable prices to the vulnerable sections in all areas, it is essential to enlarge and strengthen the distribution channels to cover all areas. It is one of the aims of our public distribution system to provide the benefits of its services even to the remote areas and thereby assure social justice.

(vi) Supply of Inputs to Priority Sectors : Ensuring supply of essential inputs to the priority sectors at reasonable prices is an important objective of the price and distribution controls. For instance, in India, certain industries are accorded priority in the allocation of certain raw materials and intermediate goods which are in short supply. Small-scale industries, export industries, agriculture and other priority sectors are given credit at concessional terms.

(vii) Allocation of Resources : Control over prices and distribution enables the planning authorities to achieve the desired pattern of resource allocation more easily. Apart from distributing the productive rersources as mentioned above, the price and distribution controls can be made use of in other ways also to achieve the objective of resource allocation. To encourage investment in a particular field, it is essential to ensure a remunerative price for the output. For this purpose sometimes price support schemes will have to be adopted. Considerable supply response to prices is noticed in case of certain agricultural commodities. In such cases deliberate variations in relative prices may be effected to redistribute the area under different crops to obtain a desirable output mix.

(viii) Prevention of Hoarding and Blackmarketing : Hoarding and blackmarketing have almost become by-products of shortage economy. An effective system of control should prevent the creation of artificial scarcity by the unscrupulous businessmen for profiteering. Laws like the Prevention of Blackmarketing and Maintenance of Supplies of Essential Commodities Act, 1980, are designed to serve this purpose.

(ix) Control of Inflation and Deflation : As it is abundantly clear from the objectives mentioned above, control of inflation is a principal objective

of price and distribution controls. In certain cases, however, prevention of fall in the prices is also the task of these controls. As there is close inter-relationship between supply and prices, price and distribution policies should mutually support each other to achieve the desired objectives.

PRICE POLICY IN INDIA

The price system can be used as a steering mechanism to secure the desired allocation of consumption and production, and thereby the inter-personal and inter-sectoral distribution of income. Hence, it is essential to have a price policy that is comprehensive enough to help achieve the various socio-economic aims. Today, the price polices of various nations aim, in general, at avoiding wide fluctuations in the price behaviour, mobilisation and optimum utilisation of resources by bringing about their rational allocation, providing price incentives for increasing production and redistribution of income in favour of the poor. The nature of price policy a nation should adopt, however, depends on the nature of the economy, objectives of development, the institutional framework, trade and commercial patterns and the overall market behaviour.

When the First Five-Year Plan of India was formulated, the planners did not appear to have bothered much about the prices. As the First Plan experienced comparative price stability, the issue of prices was not a major concern while formulating the Second Plan also. But, during the Second Plan period, prices exhibited a disturbing trend and this became a matter of major concern. Hence, a separate chapter on Price Policy was incorporated, for the first time, in the Third Plan document.

The chapter on Price Policy for the Third Plan mainly dealt with the scope and limitations of price policy and the constituents of the price policy. It stated that the price policy in a developing economy should concentrate on two main objectives : (a) it must ensure that the movements of relative prices accorded with priorities and targets that had been set in the Plan; and (b) it must prevent any considerable rise in prices of essential goods that entered into the consumption of low income groups.

Fiscal and monetary discipline was conceived as the major constituent of price policy. It pointed out that fiscal policy must be directed to mopping up the excess purchasing power which tended to push up demands above the level of available supplies. The quantum of taxation must, in other words, be adequate to keep down consumption to the limits provided for in the Plan. The requirements of public sector investment programme must be met by the transfer of real resources from the public rather than by creation of fresh purchasing power. In other words, fiscal policy in all its aspects must aim at restraining consumption and mobilising savings more effectively.

It was stressed that monetary policy should go hand in hand with fiscal policy. Just as the latter should avoid the creation of excess purchasing power through government operations, the former should regulate the pace of credit creation through banks.

The policy also recognised the scope and limitations of the commercial policy in imparting stability to the economy.

While stressing that without adequate fiscal and monetary discipline, other regulatory measures would not have the desired effect, the policy recognised that fiscal and monetary policies by themselves might also not suffice to secure the right relationship between various prices or to prevent undue hardship to low and fixed income groups. "It may be necessary, then, to have physical allocations and direct controls in certain sectors. It will be agreed, for instance, that so long as steel is scarce, it should be distributed between competing uses on the basis of agreed priorities. It may, of course, be essential to raise the price of any commodity that is scarce; but it may not be desirable from an overall point of view to get the highest bidder to get the bulk of the available supplies, leaving the rest to their own devices. If, similarly, there is a shortage of an essential drug, control of prices and distribution at a fair price to genuine users would be the appropriate course of action to adopt. The same reasoning applies to essentials of life like food or cloth. The prices of what may be called basic essentials must be held reasonably stable; in regard to commodities that are less essential, or may be classed as comforts or luxuries, a rise in prices may have to be tolerated. In the case of comfort and luxuries, in fact, an important factor in policy is the need to raise more resources; a rise in their prices does not affect the common man. The techniques of price regulation may vary from commodity to commodity; in some cases, an increase in production may be the only way to secure a reasonable level of prices. In other cases, buffer stocks, reorganisation of distribution arrangements and some direct controls may be inescapable."[1]

Thus, the Price Policy recognised the importance of fiscal and monetary policies, commercial policy, physical controls, enhancement of supply, etc., in achieving its objectives.

Successive plans have emphasised the need for achieving price stability and distributive justice. However, the basic objectives and approach enunciated in the Price Policy formulated in the Third Plan have been continued in the successive plans without any remarkable change. More and more measures have been taken by the government to realise the objectives.

PRICE CONTROLS

A number of measures have been taken to control the prices. These measures include both indirect and direct controls.

---

[1] Government of Inida, *Third Five-Year Plan* (New Delhi : Planning Commission). pp. 128-29.

INDIRECT CONTROLS

Indirect controls are exercised mainly through the monetary policy, fiscal policy and commercial policy.

The term *monetary* policy refers to the policy of the Central Bank of the country in respect of the cost and availability of credit. The rationale of using the monetary policy to control prices is that there is a very strong direct relationship between money supply and prices. *Ceteris paribus*, an increase in money supply results in an increase in prices and *vice versa*. Hence, the price rise is sought to be arrested by monetary contraction and a fall in prices is dealt with by monetary expansion.

The Reserve Bank of India (RBI) has been employing the Bank (Discount) Rate Policy, Open Market Operations and Variable Reserve Ratio Requirements—and various methods of Selective (Qualitative) Credit Control.[2]

A policy that should go hand in hand with the monetary policy to make it effective is the fiscal policy. The fiscal policy refers to the policy of the government in respect of public revenue and public expenditure. A fiscal policy can influence the price level by increasing or reducing the purchasing power of the public. Further, it can affect prices by imposing or removing or varying taxes on commodities or services, and by subsidies. Taxes, like excise duties and sales-tax, have a profound impact on the prices of commodities.

Commercial policy has also been used to a certain extent to stabilise the domestic economy. Prices can be kept under control by increasing the supply by importing goods which are in short supply. This has been done for such commodities as edible oils. Further, the government bans the export of certain items the supply position of which is not comfortable within the economy.

To prevent an unwarranted fall in the prices, the government may sometimes resort to the deliberate export of certain items.

There are other measures, too, such as buffer stock operations which can help avoid wide fluctuations in prices.

DIRECT CONTROLS

The Central and State Governments in India have armed themselves with a number of Acts to exercise direct control over the functioning of the economy. Laws like the Industries (Development and Regulation) Act, the Essential Commodities Act, the MRTP Act, the Companies Act, the Imports and Exports (Control) Act, etc., empower the Central Government to control production, supply, distribution and price in a large number of cases.

---

[2] For details of Monetary and Fiscal Policies, see chapter 7 (*Monetary and Fiscal Policies*).

With the emergence of new problems and the aggravation of existing problems, the government has been arming itself, justified or not, with more and more powers of control. Today, the production, supply, distribution, and price of a number fo commodities are subject to government control.

Administered Prices

Administered price, a term coined by Lord Keynes, refers to the price whcih is set consciously by a single decision-making body—like a monopoly firm, a cartel, or a government agency— rather than being determined by the free play of market forces.

When the market forces of supply and demand are free to interact, the price of a commodity rises when the demand for it increases relative to the supply, and the price falls when the demand declines. But under the administered price system, as the price is fixed at an artificial level, fluctuations in demand and supply do not cause any price fluctuation. In other words, the administered price is not an equilibrium price. Not only that, the administered price may not reflect the demand and supply conditions; sometimes it may not even absorb the full cost of production.

In Inida, the price of a number of key commodities are *administered* by the government. Some key commodities and services such as steel, coal, fertilizers, aluminium and electricity, whose prices are administered, account for about one-fifth of the total weight in the wholesale price index. Thus, the administered price has become an important factor affecting the general price level in India. Over 70 per cent of the goods and services sold by the public sector enterprises are subject to administered prices. These are indicative of the importance of the administered price in the Indian economy.

Administered prices are generally fixed on the recommendations of an expert body like the Bureau of Industrial Costs and Prices (BICP) or, in the case of certain public enterprises, on those of specially constituted Inter-Ministerial Committees or Groups. While recommending prices, the BICP normally goes by the guidelines for price fixation prescribed by the government and, *inter alia*, takes into account the cost of most efficient firms which account for a large percentage of the total output (to ensure a certain level of efficiency in production), the optimal norms of consumption of raw materials and energy as well as capacity utilisation, and provides a fair rate of return which has generally ranged between 10 and 14 per cent on net worth, depending on the differences with respect to factors such as risk, priority, growth prospects, etc. In order to reconcile the interests of consumers as well as producers, a system of retention prices for different producers on the basis of cost of production on the one hand and uniform sale prices for consumers on the other has been recommended, and was in operation in several cases such as steel, fertilizers, cement, etc. Price adjustments are allowed for changes in major cost components from time to time, and a review in depth is undertaken after suitable intervals.

The principle of fair return is relevant to public enterprises as well. However, these enterprises are generally engaged in the provision of infrastructural services or in the manufacture and supply of basic industrial materials such as coal, steel and POL, or agricultural inputs, such as fertilisers; and an increase in their prices generally has a cascading effect. Hence, an attempt has been made to keep down their prices. This, together with managerial deficiencies and other factors, has resulted in inadequate resource generation by the public enterprises, losses in some of them, and a heavy draft on the public exchequer. It has also meant the supply of goods and services produced in the public sector at subsidised prices even for non-priority uses, which have accentuated the imbalances between demand and supply. Further, a delay in the revision of prices results in the subsequent revisions having to be of a substantial order. There was therefore, a growing realisation that, in the context of continued inflationary pressure at home and abroad, administered prices should not be kept out of tune with other prices without heavy economic cost to the nation.

The principal aim of the administered price system is the protection of the interests of both the producers and consumers. But, in Inida, in many an instance, the system has miserably failed to safeguard the interests of the producer as well as the consumer. Price controls have retarded the growth of the concerned industries and increased market imperfections, resulting in persistent commodity shortages and rampant and flourishing blackmarkets.

Industry circles point out that many a time the price is fixed on unrealistic capacity utilisation norms, and that there is a delay in granting price increases to cover cost escalations.

Take the case of the cement industry, for instance. The unrealistic price policy has retarded the growth of the cement industry and the resultant widening of the demand-supply gap "has raised the price of cement in the blackmarket to about four times the official price. Government must also recognise that even imported cement costs twice as much as the indigenous product".

In short, the unrealistic price control policy in India, administered by inefficient and corrupt men at various administrative levels, has resulted in growing shortages and rampant blackmarketing, generating enormous black money.

BICP : Before closing this section, a word may be said about the Bureau of Industrial Costs and Prices (BICP) ; for the government determines the prices of a number of commodities on the basis of the recommendations of the BICP.

The Bureau of Industrial Costs and Price, attached to the Ministry of Industrial Development, was constituted by the Government of India in 1960 in pursuance of the recommendations of the Administrative Reforms Commission. It is an advisory body and tenders advice to the Central Government on a continuing basis on various issues pertaining to cost reduction and improvement of industrial efficiency and pricing problems in relation to industrial costs. Apart from the chairman, the Bureau has two full-time members. In addition, the Director-General of Technical Development and the Economic Adviser to the Ministry of Industry are *ex officio* members of the Bureau.

After the winding up of the *Tariff Commission* with effect from August 1,1976, the cost and economic studies which had hitherto been conducted by the Commission have been referred by the government to the BICP.

Dual Pricing

Some commodities like sugar, cotton textiles, paper and aluminium are subject to *dual pricing* in India.

The system of dual pricing has been designed to allow the weaker sections of the people or the privileged buyers like the government to get the commodity at a lower price. Under dual pricing, a part of the output of an industry is acquired by the government at a price fixed by it, which is usually lower than the market price, and the remaining part of the output can be sold by the industry at the *market* price. For instance, under the dual pricing policy for sugar, a part of the total production of sugar is to be sold to the government as levy at the price fixed by the government. The non-levy sugar (the remaining part) was allowed to be sold at the free market price. Sometimes the free market price went upto three times, the leavy price.

The dual pricing system in our country has been severely criticised. It has been argued that such controls affect capital formation and production in such industries. In industries subject to dual pricing, profitability has been found to be less than the average for all industries. However, in the paper industry, in the three years from 1974 to 1976, profitability was found to be higher than the average. It is said that the dual pricing system does not always permit the industry to make up for the loss on the levy sales by sales in the free market.

Another criticism is that the system encourages malpractices, black-marketing, tax evasion, corruption and the generation of black money.

Subsidisation

Prices of certain commodities are directly affected by the policy of subsidisation. Important commodities the prices of which are deliberately kept low by the government subsidies are foodgrains, fertilizers and controlled cloth. Certain export goods also enjoy the benefit of subsidies.

The principal objective of subsidies is the protection of weaker sections and priority sectors. For instance, foodgrains are subsidised to increase the consumption levels of the vulnerable sections. Certain export goods are subsidised to increase their price competitiveness in the international market so as to increase our foreign exchange earnings.

The effect of subsidies on prices is clear from the following facts. Replaying to the criticism in Parliament on March 13, 1981, against the subsidies on foodgrains, the Finance Minister, Mr. Venkataraman, pointed out : "If I reduce this subsidy which is Rs. 620 crores or completely eliminate it, I will have to raise the price of wheat by about 74 paise per kg and of rice by 64 paise". He further pointed out that if the subsidy of Rs. 650 crores for fertilizers had not been retained, the price of urea would have gone up from Rs. 2,000 to Rs. 2,700 per tonne—an increase of 35 per cent.

The steep increase in the outflow from the exchequer by way of subsidies has given rise to the demand for their reduction and even the abolition of certain subsidies. There are two principal arguments for reduction/abolition of subsidies, viz.,

(i) Subsidies eat into the resources for development, and

(ii) Subsidies, as they exist today, cannot be justified on grounds of economic equity and social justice.

However, there are some strong arguments for their retention. *

THE ESSENTIAL COMMODITIES ACT

Objectives

The main purpose of the Essential Commodities Act, 1955. was to provide, in the interest of the general public, for the control of the production, supply and distribution of, and trade and commerce in, certain commodities.

Essential Commodities

The government has now listed over 60 commodities as *essential commodities*. For the purpose of this Act, "essential commodity" means any of the following classes of commodities :

(i) Cattle fodder, including oil cakes and other concentrates;

(ii) Coal, including coke and other derivatives;

(iii) Component parts and accessories of automobiles;

(iv) Cotton and woollen textiles;

(v) Drugs;

(vi) Foodstuffs, including edible oil seeds and oils;

(vii) Iron and steel, including manufactured products of iron and steel;

(viii) Paper, including newsprint, paper board and straw board;

(ix) Petroleum and petroleum products;

---

* For details see Francis Cherunilam, "The Problem of Subsidies", in *Eastern Economists*, July 3, 1981.

(x) Raw cotton, whether ginned or unginned, and cotton seed;

(xi) Raw jute;

(xii) Any other class of commodity which the Central Government many, by a notified order, declare to be an essential commodity for the purpose of this Act, being a commodity with respect to which Parliament has power to make laws by virtue of Entry 33 in List III in the Seventh Schedule to the Constitution.

Control of Production, Supply and Distribution

Section 3 of the Act empowers the Central Government to regulate or prohibit the production, supply and distribution of, and trade and commerce in, any essential commodity for securing any of the following purposes :

(i) Maintaining or increasing their supplies;

(ii) Equitable distribution and availability at fair prices of the commodities concerned;

(iii) Securing any essential commodity for the defence of India or the efficient conduct of military operations.

Delegation of Powers

The Act empowers the Central Government to delegate the power of control under Section 3 to —

(a) An officer or authority subordinate to the Central Government; or

(b) A State Government or officer or authority subordinate to the State Government.

Effects of Orders Inconsistent with Other Enactments

The power of control conferred by the Act on the concerned authorities is almost absolute. Section 6 of the Act provides that an order made under Section 3 will be effective even if it is inconsistent with the provisions of any Act other than this Act.

Examination, Seizure and Confiscation

The Act authorises under it the entry, search or examination of premises, any means of transport, and the seizure :

(i) Of any articles in respect of which a contravention of the order made under the Act is suspected and any package, coverings or receptacles in which such articles are found;

(ii) Any means of transport used in carrying such articles; and

(iii) Any books of account and documents which, in the opinion of the authorised person, may be useful for, or relevant to, any proceedings under this Act.

Where any essential commodity is seized as above, a report of such seizure shall, without unreasonable delay, be made to the Collector of the district or the town in which such essential commodity is seized and whether or not a prosecution is instituted for the contravention of such order, the Collector may, if he thinks it expedient so to do, direct the essential commodity so seized to be produced for inspection before him, and if he is satisfied that there has been a contravention of the order, may order the confiscation of :

(a) The essential commodity so seized;

(b) Any package, covering or receptacle in which such essential commodity is found; and

(c) Any means of transport used in carrying such essential commodity.

Offences by Companies

If a party contravening an order made under Section 3 is a company, every person who, at the time the contravention was committed, was in charge of, and was responsible to, the company for the conduct of the business of the company as well as the company, shall be deemed to be guilty of the contravention and shall be liable to be proceeded against and punished accordingly. However, no such person shall be liable to be punished as above if he proves that the contravention took place without his knowledge or that he exercised all due diligence to prevent such contravention.

Where an offence under this Act has been committed by a company and it is proved that the offence has been committed with the consent or connivance of, or is attributable to any neglect on the part of, any director, manager, secretary or other officer of the company, such director, manager, secretary or other officer shall also be deemed to be guilty of that offence and shall be liable to be proceeded against and punished accordingly.

OTHER LAWS TO CONTROL PRODUCTION, DISTRIBUTION AND PRICES

Apart from the Essential Commodities Act, there are several Acts which empower the government to control the production, supply, distribution and price of a large number of commodities.

For the purpose of securing the equitable distribution and availability at fair prices of any article or class of articles relatable to any scheduled industry, the Central Government can, under the Industries (Development and Regulation) Act, regulate their production, supply, distribution, trade and price.

The Essential Commodities Act and the Industries (Development and Regulation) Act are supplemented by the Monopolies and Restrictive Trade Practices Act, 1969; the Prevention of Blackmarketing and Maintenance of Supplies of Essential Commodities Act, 1980; the Conservation of Foreign Exchange and Prevention of Sumuggling Act, 1947, etc.

THE PUBLIC DISTRIBUTION SYSTEM

A rapid increase in money supply and population and the slow growth in output usually create an imbalance between the demand for, and the supply of, essential consumer items. When the purchasing power of a vast segment of the population is very low, even a slight increase in the prices of wage goods seriously erodes the consumption power of the vulnerable sections. Hence, in a Welfare State, there should be some system to insulate them against such happenings. An important device we have in our country for this purpose is the Public Distribution System (PDS), under which the government makes available essential mass consumption goods at reasonable prices, especially to the poor.

Evolution of the PDS in India

During the pre-indepence era, the PDS was used as a short-term strategy to meet the war-time needs and famine conditions. With the dawn of planning, it assumed importance as one of the instruments for achieving the objectives of planning. As early as 1955, the Government of India listed a number of commodities under the Essential Commodities Act and taken legal measures to prevent the hoarding and blackmarketing of these "essential commodities".

In the initial stages, the PDS have been pressed into "off and on" operations, depending upon plentiful and depleted stocks of foodgrains in the country. Since 1956, the supplies of foodgrains under PL 480 programmes compelled the government to evolve a permanent system of a steady outlet for distribution.

In 1957, the Foodgrains Enquiry Committee, under the Chairmanship of Mr. Ashok Mehta, recommended the setting up of an organization for foodgrains' price stabilisation to counteract the fluctuations in their prices by buffer-stock operations. The presistent food crisis during the Second and Third Plan periods made the demand for an effective public distribution system more strong. In April 1959, a maiden decison of "State Trading in Foodgrains" was taken by the government. Though the decision seemed to be a remarkable one, it could not be successfully implemented. However, concrete steps for partial state trading were taken after 1963-64, when the country felt an acute shortage of foodgrains.

The emergence of serious inflationary pressures in the early 1970s made a strong demand for an effective civil supplies arrangement. The Department of Civil Supplies was set up in April 1974; in October 1974, this department was converted into the Department of Civil Supplies and Co-operation. As a nodel department, its function was to assist multi-pronged fiscal, monetary and administrative action on the part of concerned Ministries and Departments of the Central and State Governments to control inflation and to augment the production and distribution of essential commodities.

The bringing together of the Civil Supplies and Co-operation highlighted the government's policy to involve the co-operatives more actively in the public distribution system even while taking steps to strengthen the co-operative organisations, more particularly in the productive sectors.

In 1974, when the galloping inflation hit large masses of poor people very hard, the then existing public distribution system, especially for foodgrains, came under severe strain. There were shortages even of common items of mass consumption, such as vanaspati, soap and baby foods. Before the Department of Civil Supplies and Co-operation was created, there were many Ministries which were concerned with the production and administration of essential articles. Enough stress was not laid on establishing an effective distribution system. With the creation of the new department, measures were taken simultaneously on many fronts—monetary, fiscal and administrative. Since 1974, State Governments have also set up their own Civil Supplies Departments to look after the distribution of essential commodities in their respective jurisdiction.

In August 1976, the Department of Civil Supplies and Co-operation was converted into a separate Ministry. The functions of the Ministry of Civil Supplies and Co-operation are two-fold:

(i) Those relating to civil supplies and allied matters. These include:
  (a) monitoring prices, the public distribution system, consumer protection, integrated management of the supply, prices, and distribution of certain essential commodities;
  (b) regulating weights and measures; and
  (c) control of forward trading.

(ii) Those pertaining to co-operation. These include general policy in the field of co-operation, matters relating to national co-operative organisations, co-operative training, education, marketing, processing and consumer co-operation.

In 1977, with reference to the basic needs of the weaker sections of the population, measures were taken to distribute 17 essential items on a priority basis. These essential commodities were divided into three categories on the priority basis as follows:

(a) Foodgrains, namely, wheat and rice; sugar; standard cloth; vanaspati and edible oil; kerosene; soft coke; salt;

(b) Cement for housing and agricultural needs; subsidised paper for students; diesel oil for agricultural needs; essential drugs; soaps; matches; soda ash;

(c) Baby foods; tyres and tubes for cycles, scooters, buses and trucks; and common footwear.

In addition to these, steps have been taken to meet the specific requirements of particular areas—salt in the Eastern and North-Eastern regions, soft coke in the Northern and Central regions, coarse grains and pulses for industrial and agricultural labour in several deficit areas.

To meet the supply of some of these commodities, a two-fold strategy was adopted:

(i) The Commodity Approach : It envisaged the preparation of annual commodity budgets, in the widest sense, aiming at balancing the supply and demand of these commodities.

(ii) The Area Approach : It sought to ensure that essential commodities reached the vulnerable areas, such as metropolitan and large urban areas, labour concentrations in mining, industrial and plantation areas, district headquarters, hilly areas, rural areas, chronically scarcity affected or deficit districts, and areas inhabited by the vulnerable sections of population.

On July 1, 1979, the Union Government inaugurated the *production-cum-distribution* system. The main features of this system are :

(i) Every village or a group of villages having a population of 2,000 and above will have a fair price shop. In remote areas, the pupulation coverage would be even less—about 1,000.

(ii) Commodity coverage will be extended with a view to strengthening the system.

(iii) For the successful implementation of the scheme, effective arrangement will be made for the procurement, including import wherever necessary, and buffer-stocking of the commodities for distribution.

(iv) In regard to certain manufacured articles, the Central Government would assist in establishing direct links between the manufacturers and the States and their approved agencies, including co-operatives, for the distribution of such items.

(v) Special care will be taken in the production and distribution of the items of basic consumption by the vulnerable sections of society.

In early 1980, the government decided to make the PDS a permanent feature of the economy and an integral part of its price stabilisation policy.

Inaugurating a two-day conference on the "Involvement of Co-operatives in the Public Distribution System", organised by the National Co-operative Union of India (NCUI) in July 1980, Mr. V. C. Shukla, the then Union Minister for Civil Supplies, declared that "the government policy is and will be to back the co-operative movement in all fields where consumer interests are involved". **At the end of December 1991, there were about 3.75 lakh fair price shops in the country. About 75% of them were in rural areas.**

Committed as they are to uplift the weaker sections, the co-operatives have already entered the business of consumer protection with a sense of mission. Besides consumer co-operatives in urban areas, there are over one lakh village co-operative societies. At the secondary level, in semi-urban areas, there are several thousands of Agricultural Marketing Societies. Most of these, are engaged in the distribution of consumer articles, At the central level, the National Agricultural Co-operative Marketing Federation (NAFED) and the National Co-operative Consumers' Federation (NCCF) continue to carry out support price operations, maintenance of reasonable prices of essential items, creation of buffer-stocks of surplus production, etc. Thus, the co-operatives have a large base and a great potential to contribute to the successful running of the PDS. But, the co-operatives, too, have their own organisational weaknesses. They have to streamline and strengthen the existing consumer co-operative structure to take up the gigantic task of supplying essential commodities to masses in rural, semi-urban and hilly and tribal areas. Several states have also established State Civil Supplies Corporations to handle the distribution of essential commodities under the Public Distribution System.

The PDS, as it operates in our country, has been severely criticised. The major criticism is that the system is inefficient, the supply is not smooth, prompt and sufficient, and that the quality of goods supplied is poor. There is a serious allegation that some of the goods of good quality are sold secretly to private traders and low quality goods are sold to the public by the PDS. This needs to be probed into by a competent authority.

The revamped PDS, which is in operation since January 1992, is designed to cover about 1700 most backward blocks in the country. It has been decided that, besides wheat, rice, cereals, sugar and edible oils; pulses, iodised salt, tea and soap should also be made available through the PDS.

There are now more than 4 lakh fair price shops (FPSs) in the country, of which less than a lakh are in urban areas and more than 3 lakhs are in rural areas.

21

Commodity Exchange and Its Regulation

Organised markets are an aid to the efficient functioning of an economy, for they help to reduce marketing risks, increase marketing productivity, impart liquidity, provide profitable investment opportunities, augment rersources, and so on.

There are two principal types of organised markets, namely, organised *commodity market* and organised *stock market*. These organised markets are popularly known as *Commodity Exchanges* and *Stock Exchanges*.

As the Stock Exchange has been dealt with in detail in the next chapter, the discussion in this chapter is confined to Commodity Exchanges.

Commodity Exchange

A commodity exchange is an organised market where transactions in the sale and purchase of commodities—primary articles like agricultural produce and minerals or manufactrued articles—are carried out. In this market, business is transacted according to a prescribed set of rules, and participation in the business is limited to the registered members of an Exchange. It is not necessary for the commodities to be physically exchanged; only the rights to ownership are.

Commodity exchanges in India are known as "recognised associatons" under the Forward Contracts (Regulation) Act, 1952. There are a number of such associations; for example, the India Pepper and Spices Trade Association, Cochin; the Alleppey Oil Millers' and Merchants' Association, Alleppey; the East India Cotton Association Ltd., Calcutta; and so on.

Commodities Suitable for Dealing on Commodity Exchange

A commodity should have the following features if an organised market is to be developed for it :

(i) Durability.

(ii) Classification, standardisation and grading facilities.

(iii) Large supply and large demand.

(iv) Uncertainty of supply and demand.

(v) Uncontrolled and unrestricted supply and demand, i.e., free competition.

(vi) Wide fluctuations in price.

(vii) Adequate storage facilities.

SPOT AND FUTURES TRADING

The transactions in a Commodity Exchange can be classified as Spot Trading and Futures Trading.

Spot trading, also known as *cash* transaction or *non-futures* transaction, is a transaction in which the commodity is bought or sold by private transactions involving specific lots and grades for a definite delivery date either for cash or on credit.

The *futures trading* on a produce exchange refers to contracts for the future delivery of commodities. In futures trading, the commodities themselves are not brought to the futures or forward market; it is only the promises of future delivery, commonly called *futures*, that are traded.

A future contract can be effected only at the place reserved for this purpose, namely, the *Pit* or the *Ring*, and only during the hours prescribed by the exchange.

Hoffman has listed the differences between a spot contract and a futures contract as follows [1]:

	Cash Contract		*Future Contracts*
1.	Is used to market or merchandies the commodity.	1.	Is used to speculate or hedge against price changes of the commodity.
2.	Is executed at tables of the exchange or privately.	2.	Is executed in the pit or ring.
3.	Trades in irregular amounts, e.g. cartloads or lots of any number of bales.	3.	Trades in round lots, e.g.100 bales or 5,000 bushels.
4.	Varying lengths of time used for delivery.	4.	A particular future month named is used for delivery.
5.	May or may not have optional period of delivery.	5.	Seller's option of the day of delivery.
6.	Usually calls for specific grade or type of commodity for fulfilment.	6.	Seller's option of grade of a commodity to be delivered.

Future contracts are stadnard contracts under the rules of the trading exchange. The contract has to be drawn up in the standard form prescribed by the exchange. It is always subject to the bye-laws and rules governing futures trading. A futures contract entered into outside the exchange is illegal.

---

[1] Cited in Pratap, R. N., *Futures Trading in India* (Dissertation submitted in part fulfilment of the Master's Degree Examination in Commerce of the University of Mysore, 1972).

The need for futures trading arises from :

(i) The need for protection against risk of price changes;

(ii) The need for stabilising prices; and

(iii) The need for the price registering function.

The primary service of the futures market lies in its provision of a means of insurance against the riks of adverse price flucuations between the time of the produciton of the commodity and its final utilisation. The insurance function is carried out by *hedging* or taking an opposite position on the futures market from that held in the spot market. This enables the market functionaries to charge low rates of commission for their services. The cost of marketing is thus reduced.

A futures market, by reducing market imperfections, helps to minimise price fluctuations. Price differences between different places are eliminated or minimised by *arbitrage* operations carried on by the speculators. A produce exchange cellects all the data relevant to the commodity it deals in. A proper dissemination of market information helps to minimise upward or downward price swings, and enables the producers and consumers to sell and buy commodities at more competitive and reasonable prices.

The commodity exchange collects and disseminates information on all the prices of the commodity, including the prices which the speculative investors are willing to pay many months ahead. This ensures in element of certainty and stability in all the phases of business transactions. This function of the future market acts as a price barometer for producers, industry, exporters, consumers, etc., and enables them to plan their produciton, trading and other activities more profitably.

While the futures market serves some very useful purposes, it is also susceptible to speculative manipulations which sometimes may turn out to be detrimental to the public interest, particularly of the farmers and consumers.

REGULATION OF THE COMMODITY EXCHANGE

Various activities on a commodity exchange are regulated by provisions of certain laws, some of which have been dealt with in some other chapters of this book. The piece of legislation particularly designed to regulate the futures trading, a major business on an organised commodity exchage, needs to be treated in this chapter in some detail.

The Forward Contracts (Regulation) Act

The Forward Contracts (Regulation) Act was passed by the Government of India in 1952 to enable it to regulate the functioning of the futures market in the national interest.

The Act defines the forward contract "as a contract for the delivery of goods at a future time and which is not a ready delivery contract." The ready delivery contract means, according to the Act, a contract which provides for the delivery of goods and the payment of a price, therefore, either immediately or within such period not exceeding eleven days after the date of the contract and subject to such conditions as the Central Government may, by notification in the official Gazette, specify in respect of any goods, the period under such contract not being capable of extension by the mutual consent of the parties thereto or otherwise.

The salient features of the Act are given below:

(i) It enables the regulating authority to take such action as may be considered desirable, in respect of specified commodities and specified areas. When Section 15 of the Act is applied to a commodity in an area by a Gazette of India Notification, forward contracts cannot be entered into in that commodity in that area otherwise than between members of a recognised association or through or with any such members.

(ii) Section 19 of the Act prohibits *option trading* in all commodities (option trading is a sale of pruchase of a right to purchase or sell certain commodities within a fixed time at a price agreed upon at the time the option is purchased). This measure is intended to check the volume of speculation.

(iii) The Act ordinarily exempts non-transferable specific delivery (NTSD) contracts from its regulation, though provision has been made for their control by a notification by the Union Government.

(iv) The act ordinarily covers transferable spcific delivery (TSD) contracts and hedge contracts. However, if it is felt that these contracts can be left free from regulation, in any area or in any commodity, the Act permits the exemption of such contracts from the regulation, by a notification under the Act.

(v) Section 17 of the Act empowers the Government to prohibit forward contracts in a particular commodity altogether by a notification.

(vi) The Act provides for the grant of recognition to associations concerned with forward trading, which is liable to be withdrawn if the Central Government considers it desirable to do so.

(vii) It provides that the regulation of forward markets should ordinarily be done by the governing bodies of recognised associations. But the Government has the power to supersede the governing body. It has the final say in amendments to the bye-laws and constitution of the recognised associations. It can also amend the constitution and bye-laws on its own initiative.

(viii) The Central Government is empowered under the Act to appoint not more than four members on the governing bodies of recognised associations.

(ix) The Act empowers the Central Government to call for periodical returns, annual reports or any other information from recognised associations, to hold an enquiry into the affairs of the association or any of its members.

(x) Further, under the Act, the Government has the power to establish an Advisory Committee; has the power to delegate its powers exercisable under the Act; has the power to exempt any contract or contracts from any or all the provisions of the Act; and has the power to make rules.

(xi) The Act provides for a machinery for the supervision and regulation of the governing bodies of the associations. This machinery is known as the Forward Markets Commission.

(xii) By an amendment of the Act in 1960, all associations dealing in forward contracts were required to register themselves with the Forward Markets Commission, irrespective of whether they deal in hedge contracts, TSD contracts or NTSD contracts.

The Forward Markets Commission

In accordance with the terms of the Forward Contracts (Regulation) Act, the Centrtal Government established the Forward Markets Commission in 1953. The Commission has both advisory and executive functions. As an advisory body, it advises the Central Government on the application of the various provisions of the Act and the recognition of associations. As an executive body, it gives directions to recognised associations and exercises such other powers as may be assigned to it by or under this Act.

The following are the functions of the Commissioner as set out in Section 4 of the Act:

(a) To advise the Central Governemnt on the recognition of, or the withdrawal of recognition from, any association or in respect of any other matter arising out of administration of the Act;

(b) To keep forward markets under observation and to take such action in relation to them as it may consider necessary in exercise of the powers assigned to it by or under this Act;

(c) To collect and, whenever the Commission thinks it necessary, to publish information on the trading conditions of the goods to which any of the provisions of this Act is made applicable, including information on supply, demand and prices, and to submit to the Central Government periodical reports on the operation of this Act and on the working of the forward markets relating to such goods;

(d) To make recommendations, generally with a view to improving the organisation and working of forward markets;

(e) To undertake the inspection of the accounts and other documents of any recognised association or registered association or any member of such association, whenever it considers it necessary; and

(f) To perform such other duties and exercise such other powers as may be assigned to the Commission by or under this Act or may be prescribed.

The Forward Markets Commission has the following powers:

(i) Power to approve amendments to the rules of recognised associations;

(ii) Power to direct rules to be made or amend or make rules;

(iii) Power to make or amend bye-laws of recognised associations;

(iv) Power to call upon a recognised association to furnish an explanation of its affairs or the affairs of any of its members; and

(v) Power to suspend the business of a recognised association.

22

Money and Capital Markets

The size, nature, conditions and operations of the money and capital markets have important bearing on the economic development, especially of the industry and commerce, of the country. The State has been making a significant contribution towards the healty development of these markets. The activities of money and capital markets have been controlled by the State (including the Reserve Bank of India) with a view to making them serve the national objectives.

Meaning of Money Market

Money Market is the market for short-term loanable funds, as distinct from the Capital Market which deals in long-term funds.

Sometimes the term Money Market is used in a very broad sense to include markets for both the short-term and long-term funds. When the term is used in such a broad sense, Money Market includes, obviously, the Capital Market also. However, when a distinction is drawn between the Money Market and the Capital Market, the former refers only to the market for short-term funds, and the latter for long-term funds. As we draw, in this chapter, a distinction between these two, Money Market should be interpreted as the market for short-term funds.

In the words of the Reserve Bank of India, a Money Market is a "centre for dealings, mainly of a short-term character, in monetary assets; it meets the short-term requirements of the borrowers and provides liquidity or cash to lenders. It is the place where short-term surplus investible funds at the disposal of the financial and other institutions and individuals are bid by borrowers, again comprising institutions and individuals and also by the government."

Thus, a Money Market is a place where the lending and borrowing of short-term funds are arranged and it comprises the short-term credit instruments and the institutions and individuals who participate in the lending and borrowing business.

Constituents of a Money Market

Dr. Lavington divides the money market into inner and outer spheres—the inner constituting "a nucleus of specialised institutions such as the banks, the market for negotiable securities, the bill brokers and the trust and finance companies, and the outer extending beyond this centre, including the work of solicitors, of brokers of securities and the entire system of trade and credit."

The Central Bank, Commercial Banks, Co-operative Banks, Savings Bank, Discount Houses, Acceptance Houses, etc., are the main constituents of a well developed money market. However, some of these institutions would not be found in many money markets.

The Central Bank usually occupies a pivotal position in the money market. It is regarded as the 'presiding deity' of the money market. A strong central bank in an organised money market can very significantly influence the conditions and activities of the market. In developing economies like India, organisation and development of a full-fledged money market is one of the prime responsibilities of the Central Bank.

In developing countries like India, the money market is broadly divided into organised and unorganised markets or sectors. The unorganised segment is by and large outside the control of the Central Bank and is characterised by lack of uniformity and formality in their business dealings. In India, the indigenous bankers and moneylenders are important constituents of the unorganised money market.

A developed money market consists of certain specialised sub-markets like the Stock Market, Bill Market, Bullion Market, etc. These sub-markets help the mobilisation of savings by providing fruitful investment opportunities. They are also very helpful in imparting liquidity.

Certain specialised organisations like information bureaus, chambers of commerce, trade associations, etc., help the smooth and efficient functioning of the money market by helping the collection and dissemination of information to industry, trade and commerce.

Functions of Money Market

As the Reserve Bank of India observes, "A well-developed money market is the basis for an effective monetary policy. It is in the money market that the Central Bank comes into contact with the financial sectors of the economy as a whole and it is through varying the liquidity in the market and thereby influencing the cost and availability of credit that the Bank achieves its economic objectives."

The important functions of a well developed money market may be listed down in more precise terms as follows :

(1) By providing various kinds of credit instruments suitable and attractive for different sections, a money market augments the supply of funds.

(2) Efficient working of a money market helps to minimise the gluts and stringencies in the money market due to the seasonal variations in the flow of and demand for funds.

(3) A money market helps to avoid wide seasonal fluctuations in the interest rates.

(4) A money market, by augmenting the supply of funds and making them readily available to the legitimate borrowers, helps in making funds available at cheaper rates.

(5) A well organised money market, through quick transfer of funds from one place to another, helps to avoid the regional gluts and stringencies of funds.

(6) It enhances the amout of liquidity available to the entire country.

(7) A money market, by providing profitable investment opportunities for short-term surplus funds, helps to enhance the profit of financial institutions and individuals.

A money market functions like a dam-canal-irrigation system. Like a reservoir it collects and augments the resources and channelises it to the various needed areas.

A well organised money market is an essential condition for the successful operation of the Central Banking Policies. The money market is "the locus of central banking policies for holding the conditions of liquidity within the bounds of what the monetary authorities consider desirable".

THE INDIAN MONEY MARKET

As the Reserve Bank observes, "As in most developing countries, the money market in India comprises two sectors which may broadly be termed as the Organised and Unorganised markets, with substantially higher rates of interest in the unorganised sector."

The *organised market* comprises in the first place the Reserve Bank which is "the key constituent of the money market being the residual source of supply of funds and it is this which invests the Bank's operations with great significance," and occupies "a strategic position in the money market."

Then come the commercial banks. They include the public sector banks and other joint stock banks, Indian and foreign.

In the past, quasi-government bodies and large size joint stock companies also used to participate in the operations of the money market as lenders, the money lent by them being usually termed '*house money*'. In recent years, such 'house money' has declined to negligible proportions. Most of the joint stock companies have no surplus fund to lend and they are in fact in search of funds which they obtain partly by accepting deposits from the public.

Then there are the financial intermediaries such as call loan brokers and general finance and stock brokers. "The core of the Indian moeny market is the inter-bank call money market." Although the magnitude of funds dealt in this market is not large in relation to the deposit resources of banks, "perhaps this is the most sensitive sector of the money market." The State Bank of India does not participate in the call money market but other banks obtain loans and advances from the SBI. In the last four decades or so the banks have increasingly directed their demands for accommodation to the Reserve Bank.

In the Indian system *there is no true market for bills*, either Commercial or Treasury; nor is there any acceptance business. However, the Reserve Bank claims : "From the point of view of specialisation of functions and organised relationships, the Indian money market may be considered to be comparatively well-developed".

The *unorganised sector*, which itself is not homogeneous, is largely made up of what are known as "indigenous" bankers. In this market there is no clear demarcation between short-term or long-term finance, in as much as there is usually nothing on the *hundi** to indicate whether it is for financing trade or for providing financial accommodation—in other words, whether it is genuine trade bill or financial paper. By and large, these bills are accommodation bills. In view of the paucity of trade bills, there is no discount market in India, though banks, especially the foreign banks, discount bills. Trade bills are usually carried until maturity (for example, import bills) or discounted in London (for example, export bills).

The *co-operative credit institutions* occupy a somewhat intermediate position between the organised and unorganised sectors of the money market. With the notable increase in the number of commercial bank branches in the rural and semi-urban areas closer links have been forged between the co-operative credit system and the organised money market, especially with the State Bank and its subsidiaries.

The money market structure in Inida, loosely knit as it is, is not entirely unco-ordinated. The indigenous bankers enjoy rediscount facilities from the commercial banks which in turn have access to the Reserve Bank.

A well-developed money market will have close links with the leading money markets of the world and will be sensitive to the developments in these foreign markets. But "the Indian money market is an insular one with little contact with foreign money markets." The money markets of advanced Western countries are characterised by large movements of capital between them. Due partly to the exchange control restrictions on capital movements, there is hardly any movement of funds between the Indian money market and the foreign market.

---

* A *hundi* is an indigenous Bill of Exchange.

CAPITAL MARKET

Capital Market is generally understood as the market for long-term funds. However, sometimes the term is used in a very broad sense to include also the market for short-term funds. For instance, H.T. Parekh in his *Indian Capital Market —Past, Present and Future* states : "By capital market, I mean the market for all the financial instruments, short-term and long-term, as also commercial, industrial and government paper." When 'Capital Market' is used in such a broad sense, it embraces, obviously, the money market also.

However, in most cases, the term Capital Market is used to refer to the market for long-term loanable funds as distinct from the money market which deals in short-term funds. It should, however, be added that there is no clear-cut distinction between the two markets. Many a time the same institutions receive and supply both short and long-term funds. The money and capital markets are in fact inter-dependent, developments and trends in one affecting the other.

Nature and Constituents

The capital market consists of a number of individuals and institutions (including the government) that canalise the supply and demand for long-term capital and claims on capital. The stock exchanges, commercial banks, co-operative banks, savings banks, development banks, insurance companies, investment trusts or companies, etc., are the important constituents of the capital market.

The capital market, like the money market, has three important components, namely, the suppliers of loanable funds, the borrowers and the intermediaries who deal with the lenders on the one hand and the borrowers on the other.

In the capital market, the supply of funds comes from the individual and corporate savings, institutional investors and the surplus of governments. The demand for capital comes fromt the agriculture, industry, trade and the government.

With the emergence of joint stock companies as the predominant form of industrial organisation, developed capital market became a necessary infrastructure for fast industrialisation. Business firms can raise funds from the capital market by issuing shares and credit instruments. Capital market is not concerned solely with the issue of new claims on capital, but also with dealings in existing claims. In fact, marketability, of securities is an important element in the efficient working of the capital market, since investors would be reluctant to make loans if their claims could not be easily disposed of.

The developed countries have comparatively well-developed money and capital markets. But, in the developing countries the capital market, like the money market, is generally underdeveloped.

Importance of Capital Market

The pace of economic development is conditioned, among other things, by the rate of long-term investment and capital formation. And capital formation is conditioned by the mobilisation, augmentation and channelisation of investible funds. The capital market serves a very useful purpose by pooling the capital resources of the country and making them available to the enterprising investors. Well-developed capital markets augment resources by attracting and lending funds on a global scale. The *Euro-currency* and *Euro-bond* markets [1] are international finance markets in terms of both the supply and demand for funds.

The increase in the size of the industrial units and business corporations due to technological developments, economies of scale and other factors has created a situation wherein the capital at the disposal of one or few individuals is quite insufficient to meet the investment demands. A developed capital market can solve this problem of paucity of funds. For an organised capital market can mobilise and pool together even the small and scattered savings and augment the availability of investible funds. While the rapid growth of joint stock companies has been made possible to a large extent by the growth of capital markets, the growth of joint stock business has in its turn encouraged the development of capital markets.

A developed capital market provides a number of profitable investment opportunities for the small savers.

CAPITAL MARKET IN INDIA

Nature of the Indian Capital Market

Like the money market, the Indian capital market also consists of an organised sector and an unorganised sector. In the organised market the demand for capital comes mostly from corporate enterprises and government and semi-government institutions and the supply comes from household savings, institutional investors like banks, investment trusts, insurance companies, finance corporations, government and international financing agencies.

The unorganised market consists mostly of the indigenous bankers and moneylenders on the supply side. While in the organised sector the dmand for funds is mostly for productive investment, a large part of the demand for funds in the unorganised market is for consumption purposes. In fact, many purposes for which funds are very difficult to get from the organised market are financed by the unorganised sector. Like the unorganised money market, the unorganised capital market in India is characterised by the existence of multiplicity of interest rates, exorbitant rates of interest and lack of uniformity in their business dealings.

---

[1] *Euro-currency* or *Euro-dollar* refers to a currency internationally supplied and demanded and in which a foreign bank is willing to accept liabilities and loan assets. Thus, Dollar deposits with banks in London, Bonn, Paris, Montreal, Toronto, Singapure, Beirut, Bombay, etc., are Euro-dollars, so are deposits denominated in currencies other than the US Dollar in the money markets of the USA. The Euro-dollar market is the market for short-term funds and the corresponding market for long-term funds is the *Euro-bond* market. However, many a time the term Euro-dollar market is used in a broader sense to include both the short-term and long-term dealing.

While the activities of the organised market are subject to a number of government controls, the unorganised sector is by and large outside effective government control.

The organised sector has been subjected to increasing institutionalisation. A large chunk of the business of this sector is accounted for by the public sector financial institutions, and the government control over other segments of the organised capital market has increased over the years.

Development of the Market

The Indian capital market has undergone remarkable changes in the post-independence era. Certain steps taken by the government to place the market on a strong footing and develop it to meet the growing capital requirements of fast industrialisation and development of the economy have significantly contributed to the developments that took place in the Indian capital market during the last four decades or so.

The important factors that have contributed to the development of the capital market in India are the follwoing :

(1) *Legislative measures* : Laws like the Companies Act, the Securities Contracts (Regulation) Act and the Capital Issues (Control) Act empowered the government to regulate the activities of the capital market with a view to assuring healthy trends in the Market, protecting the interests of the investors, efficient utilisation of the resources, etc.

(2) *Establishment of Development Banks and expansion of the public sector* : Starting with the establishment of the IFCI, a number of development banks have been established at the national and regional levels to provide financial and other development assistance to the entrepreneurs and enterprises. These institutions today account for a large chunk of the industrial finance.

The expansion of the public sector in the money and capital markets has been accelerated by the nationalisation of the insurance business and the major part of the banking business. The Life Insurance was nationalised in 1956 and the General Insurance in 1972. The Reserve Bank of India was nationalised as early as 1949. The Imperial Bank, the largest commercial bank in India, was nationalised and established the State Bank of India in 1955. The fourteen major private commercial banks were nationalised in

1969. With the nationalisation of the six leading private banks in 1980, over 90 per cent of the commercial banking business came to be concentrated in the government sector.

Thus, an important aspect of the Indian capital market is that a large part of the investible funds available in the organised sector is owned by the government. The new economic policy will change the trend.

(3) *Growth of underwriting business*: There has been a phenomenal growth in the underwriting business thanks mainly to the public financial corporations and the commercial banks. After the elimination of the forward trading, brokers have begun to take on underwriting risks in the new issue market. In the last one decade the amount underwritten as percentage of total private capital issues offered to public varied between 72 per cent and 97 per cent.

(4) *Public confidence*: Impressive performance of certain large companies encouraged public investment in industrial securities.

(5) *Increasing awareness of investment opportunities*: The improvement in education and communication has created more public awareness about the investment opportunities in the business sector. The market for industrial securities has become broader.

Recent Developments

Particularly since the mid 1980s, there has been a very remarakable uptrend in the new issues market and in the stock market, culminating in a tremendous boom in the stock market in recent years. Many issues, including some mega issues have been very highly oversubscribed.

The equity cult is growing very fast in India. The number of shareholders increased from two million in 1980 to seven million in 1985 and was projected to reach 15 million by 1990. In 1988, the Reliance Industries with over 3 million shareholders became the second largest company in the world in terms of the number of shareholders.

The growth of the *mutual funds* is another remarkable recent development. The mutual funds which serve an investor population of several millions were estimated to have an investible fund of around Rs. 18,000 crores at the end of March 1990, UTI alone accounting for Rs. 15,892 crores.

The Budget for 1992-93 made the following important proposals in respect of the capital market:

1. Government control over capital issues, including premium fixation, will be abolished. Companies will be allowed to approach the market directly, provided the issues are in conformity with published guidlines related to disclosure and other matters related to investor protection.
2. Mutual funds are allowed in the private sector also.

(3) Companies with good track record will be permitted to issue convertible debentures or equity to investors abroad and to extend to these issues the same tax benefits as available for offshore mutual funds. This is to enable domestic companies to tap the large pool of equity funds available in the world capital markets.

(4) Governments will also consider ways of allowing reputable foreign investors to invest in Indian capital market with suitable mechanisms to ensure that this does not threaten loss of management control.

These proposals are part of the economic reform being ushered in India.

CAPITAL MARKET REFORMS AND DEVELOPMENTS

The number of Stock Exchanges has increased gradually and the capital market has expanded substantially. However, the functioning of the stock exchanges shows many shortcomings with long delays, lack of transparency in procedures and vulnerability to price rigging and insider trading. To counter these deficiencies Government established the Securities Exchange Board of India (SEBI) in 1988 and it was given statutory powers by an ordinance promulgated on 30th January 1992. SEBI has wide ranging powers of control over the capital market.

The Capital Issues (Control) Act, 1947, was repealed in May 1992, and the office of the Controller of Capital Issues (CCI), was subsequently abolished. With the abolition of CCI, prior Government permission was no longer needed by companies to access the capital markets. Companies are free to approach the capital markets without prior Government permission subject to getting offer documents cleared by SEBI. Control over price and premium fixation has also been removed and most issuing companies are free to fix the price of their securities for public as well as rights issues.

Indian companies have been permitted to access international capital markets through Euro-equity issues aimed at mobilising capital for modernisation and import requirements. Several companies have been given such permission.

A number of other steps have also been taken in recent years by the Government and SEBI to introduce improved practices and greater transparency in the capital markets in the interest of healthy capital market development.

(i) SEBI has been authorised to conduct inspections of various mutual funds. These inspections have been conducted and SEBI has submitted a report on each inspection which brings out various deficiencies of individual mutual funds. Corrective steps are being taken to set right these deficiencies.

---

* Excerpted from Government of India, *Economic Survey 1992-93* and *1994-95.*

(ii) SEBI has also drawn up a programme of inspecting stock exchanges.

(iii) The process of registration of intermediaries such as stockbrokers and sub-brokers has been provided under the provisions of the Securities and Exchange Board of India Act, 1992. The registration is on the basis of certain eligibility norms such as capital adequacy, infrastructure etc.

(iv) Companies issuing capital in the primary market are now required to disclose all material facts and specific risk factors associated with their projects.

(v) Merchant banking has been statutorily brought under the regulatory framework of SEBI. The merchant bankers are now to be authorised by SEBI. They will have to adhere to stipulated capital adequacy norms. Merchant bankers have to abide by a code of conduct which specifies a high degree of responsibility towards investors in respect of the pricing and premium fixation of issues, and disclosures in the prospectus or offer letter for issues.

(vi) The National Stock Exchange of India (NSEI) has been established by financial institutions and banks with IDBI as nodel agency. The NSEI is expected to serve as a model exchange integrating the stock markets all over the country by providing nation-wide stock trading facilities and electronic clearing and settlements. Over the Counter Exchange of India (OTCEI) was also established.

(vii) In order to induce companies to exercise greater care and diligence for timely action in matters relating to the public issue of capital, SEBI has advised the stock exchanges to collect from companies making public issues, a deposit of one per cent of the issue amount which could be forfeited in case of non-compliance with the provisions of the listing agreement and, non-dispatch of refund orders and share certificates by registered post within the prescribed time.

(viii) Regulations on insider trading under the provisions of the SEBI Act have been notified. Such regulations will help in protecting and preserving the market's integrity and in the long run help inspire investor confidence in the market.

(ix) RBI has liberalised the investment norms evolved for NRIs by allowing companies to accept capital contributions and issue shares or debentures to NRIs or overseas corporate bodies without prior permission.

(x) The Government has allowed foreign institutional investors (FIIs) such as pension funds, mutual funds, investment trusts asset or portfolio management companies etc. to invest in the Indian capital market provided they register with SEBI.

(xi) To make the governing body of a stock exchange more broad based SEBI has issued guidelines for its composition. According to these guidelines the governing body of the stock exchanges should have five elected members, not more than four members nominated by the Government or SEBI and three or fewer members nominated as public representatives, besides its executive director.

(xii) The 'Banker to the Issue' has been brought under purview of SEBI for investor protection.

(xiii) The 'due diligence certificate' by lead managers, regarding disclosures made in the offer document, has been made a part of the offer document itself for better accountability and transparency on the part of the lead managers.

(xiv) New reforms by SEBI in the primary market included improved disclosure standards, introduction of prudential norms and simplifications of issue procedures. Companies are required to disclose all material facts and specific risk factors associated with their projects while making public issues.

(xv) Stock exchanges are advised to amend the listing agreement to ensure that a listed company furnishes annual statement to the stock exchanges showing variations between financial projections and projected utilisation of funds made in the offer documents and actuals. This will enable shareholders make comparisons between performance and promises.

(xvi) SEBI introduced a code of advertisement for public issues for ensuring fair and truthful disclosures.

(xvii) To reduce cost of issue, underwriting by issues made optional, subject to the condition that if an issue was not underwritten and was not able to collect 90 per cent of the amount offered to public, the entire amount collected would be refunded to the investors.

(xviii) Redressal of complaints of investors is to be encouraged sharing it with recognised investor associations. This will facilitate filing of class action suits in consumer courts against erring companies.

(xix) SEBI introduced regulations governing substantial acquisition of shares and takeovers and lays down the conditions under which disclosures and mandatory public offers are to be made to the shareholders.

(xx) Renewal of transactions in 'B' group securities is prohibited, so that transactions could be settled within 7 days.

(xxi) Private mutual funds are permitted and a few such funds have already been set up. All mutual funds allowed to apply for firm allotment in public issues.

(xxii) UTI has been brought under the regulatory jurisdiction of SEBI.

(xxiii) To improve the scope of investments by mutual funds, mutual funds have been permitted to underwrite public issues and the guidelines for investment in money market instruments were relaxed.

(xiv) The practice of making perferential allotment of shares at prices unrelated to the prevailing market prices was stopped and fresh guidelines were issued by SEBI.

(xxv) The procedures for lodgement of securities for transfer was considerably eased for domestic and FII's through the introduction of 'jumbo' transfer deeds and consolidated payment of stamp duty.

The process of reforms in the capital market has only just begun. It needs to be deepened to bring about speedier conclusion of transactions, greater transparency in operations, improved services to investors, and greater investor protection while at the same time encouraging the corporate sector to raise resources directly from the market on an increasing scale. Major modernisation of the stock exchanges to bring them in line with world standards in terms of transparency and reliability is also necessary if foreign capital is to be attracted on any significant scale.

23

Stock Exchange and its Regulation

Meaning, Importance and Functions

Stock Exchange is a market in which securities are brought and sold and it is an essential component of a developed capital market.

According to the Securities Contracts (Regulation) Act, 1956, *stock exchange means anybody of individuals, whether incorporated or not, constituted for the purpose of assisting, regulating or controlling the business of buying, selling or dealing in securities.* According to this Act, *securities* include (i) shares, scrips, stocks, bonds, debentures, stock or other marketable securities of a like nature in or of any incorporated company or body corporate; (ii) Government securities; such other instruments as may be declared by the Central Government to be securities; and (iii) right or interest is securities.

Stock exchange is regarded as "an essential concomitant of the capitalistic system of economy. It is indispensable for the proper functioning of corporate enterprise. It brings together large amounts of capital necessary for the economic progress of a country. It is the citadel of capital and the pivot of money market. It provides necessary mobility to capital and directs the flow of capital into profitable and successful enterprises. It is the barometer of general economic progress in a country and exerts a powerful and significant influence as a depressant or stimulant of business activity. It may be defined as the place or market where securities of joint stock companies and of government or semi-government bodies are dealt in."[1]

---

[1] S.C. Kuchhal, *Corporation Finance: Principles and Problems*, (Allahabad: Chaitanya Pub. Co.,) 1976, p. 261.

Speaking in the *Lok Sabha* in connection with his motion for reference of the Securities Contracts (Regulation) Bill to a Joint Committee of the Houses of Parliament in 1955, the Finance Minister made the following observations:

"The economic services, which a well constituted and efficiently run securities market can render to a country with a large private sector, operating under the normal incentives and impulses of private enterprises are considerable. In the first place, it is only an organised securities market which can provide sufficient marketability and price continuity for shares, so necessary for the needs of investors. Secondly, it is only such a market that can provide a reasonable measure of safety and fair dealing in the buying and selling of securities. Thirdly, through the interplay of demand for and supply of securities, properly organised stock exchange assists in a reasonably correct evaluation of securities in terms of their real worth. Lastly, through such evaluation of securities the stock exchange helps in the orderly flow and distribution of savings as between different types of competitive investments."[2]

Dealings on Stock Exchange

Dealings on the stock exchange are subject to the bye-laws and rules of the stock exchange. Stock exchange dealings in India are regulated by the Securities Contracts (Regulation) Act. On the trading floor of the stock exchange, dealings are permitted only in the listed securities through the members or their authorised clerks during fixed working hours.

There are two important types of trading on the stock exchange namely *Ready Delivery* contract and *Forward Delivery* contract. The important differences between these two dealings are the following:

(i) Ready delivery contracts, also known as *cash trading* or *cash transactions,* are to be settled either on the same date or within a short period that may extend at best up to seven days. (If the payment and delivery of securities is on the same day or on the next day, it may be called *spot delivery contract*). As against these, the forward delivery contracts are discharged on fixed settlement days occurring at fortnightly intervals.

(ii) Forward delivery contracts enjoy the facility of 'carry-over' whereas ready delivery contracts must be settled within the specified limit and they cannot be carried over to an extended period.

(iii) Ready delivery contracts can be made in respect of all securities whereas forward delivery contracts are confined to those securities which are placed on the forward list.

Speculation on the Stock Exchange

Stockexchange transactions are made either for the purpose of investment or for speculation. Investment transactions are made with the intention of earning a return on the securities by holding them more or less permanently whereas speculative transactions are made with the intention of making gains by disposing of the securities at favourable prices.

---

[2] Cited the *Reserve Bank of India Bulletin,* October 1956, p. 1025

The nature of the investment transaction and speculative transaction differs. The investment transactions require the actual delivery of securities on the part of sellers and the payment of their full price by the buyers. Speculative transactions, on the other hand, does not involve full payment for and taking delivery of the securities that the speculators have contracted to transfer. As the speculative transactions do not call for the payment of the full price but can be made by the deposit of a fractional part of the price, the volume of speculative transactions usually far exceed that of the investment transactions on any stock exchange. It is, therefore, argued that speculation is necessary to ensure sufficient volume and continuity of business in the stock exchange. However, unregulated speculation is not conducive. Introducing the Securities Contracts (Regulation) Bill, the then Finance Minister Mr. C.D. Deshmuk observed:

"Sceptics may argue that it is impossible for any securities market to function properly because of the undesirable activities of speculators, and yet genuine speculation, which is based on a reasoned forecast of the real value of the investments, represented by the securities which are dealt with on the exchanges, performs a very important function. No stock exchange can operate purely on the basis of investment buying or selling, because "pure " investors in that sense are necessarily few in number and usually possess very limited resources. They cannot provide the requisite volume or continuity of business, which alone would enable a large number of buyers and sellers to trade at all times in the exchanges, and to bring about an adjustment of the relative values of the securities in which they trade, in conformity with their real worth. It is the buying and selling of securities on a large scale on the basis of reasoned forecasts which alone can give the necessary breadth and continuity to the market. Informed speculation, which takes a reasonable view of future prospects, and thus brings about an appropriate adjustment security values, thus helps not only in the channeling of savings into the most productive lines, but also attracts new savings for investment into particular classes of securities. Too often, unfortunately, speculation in shares and scripts is not based on any reasoned calculation of the prospects of a company, and comes very close to gambling. The basic object of stock exchange reform is, therefore, to regulate speculative activities so that they may not degenerate into gambling; it is not the object of such reform to interfere with investment buying or selling or even with speculation as long as it conforms to the rules of the game."

Types of Speculators: The speculartors on a stock exchange may be categorised into the following three *(i) Bull:* A bull, also known as *Tejwalla,* is a speculator who buys shares in the expectation of selling it at a higher price later; *(ii) Bear:* A bear, also known as *Mundiwalla,* who sells securities in the expectation of a fall in their prices in future; *(iii) Stag:* A stag neither buys nor sells but applies for subscription to the new issues expecting that he can sell them at a premium.

Option Dealing: Option is the right to buy or sell a certain quantity of security at a certain price within a certain time. The option to buy is known as *call option* (or *Teji Sauda*) and the option to sell is known as *Put Option* (*Mandi Sauda*). The *Put* and *Call* is a double option (known as *Teji-Mandi*) giving the right either to purchase or to sell securities. In an option dealing, a speculator is given the right or option to buy or sell, or both buy and sell, as the case may be on the settlement day or else he will forefeit the option money.

Blank Transfers: Blank transfer means the transfer of a security without specifying the transferee. Although a blank transfer is not, by itself, a speculative transaction, it encourages speculation in securities because the same transfer deed without any stamp duty revolves into many sale transactions in securities embodied therein. It also encourages tax evasion. The option of the Gorwala Committee appointed by the Government to draft legislation for regulation of stock exchange was divided on the subject of blank transfers. The Securities Contracts (Regulation) Act only indirectly regulates the blank transfers.

Carry-over (Budla) Transactions: Carry-over or Budla refers to the facility of carry-over of the completion of a forward contract to another next settlement period any number of times on payment of the budla charge. The budla charge paid by a bull is known as *contago* and that paid by the bear is called *backwardation.*

Organisation of Stock Exchange in India

There are 21 stock exchanges functioning in India. Besides, there is an Over the Counter Exchange of India (OTCEI) and the National Stock Exchange (NSE).

The Bombay Stock Exchange established in 1875 is the first stock exchange in India.

With over 7500 listed companies, India holds the unique distinction of having the largest number of listed companies in the world. The number of investors, roughly estimated at 40 million, including the mutual funds, is the second largest in the world.[3]

Since the coming into effect of the Securities Contracts Act, 1956, only those stock exchanges which are recognised by the Government can function in the country. The policy of the Government is that there shall be only one stock exchange in one area. In pursuance of this policy, where more than one stock exchange existed as in Bombay only one stock exchange was given recognition and the active members of the non-recognised stock exchanges were admitted

---

[3] T.S. Anantharaman "Emergence of Indian Capital Market", Cochin Stock Exchange Monthly Bulletin, February 1995, p. 45

Some stock exchanges like Bombay, Indore and Ahmedabad are organised as Voluntary Association; some like Calcutta and Delhi are organised as public limited companies whereas some like Hyderabad, Madras and Bangalore are guarantee companies.

Each stock exchange is managed by an Executive Committee/Council of Management/Governing Body to which the Government is empowered to nominate not more than three members. The rules and bye-laws of the stock exchange shall be in conformity with such conditions as may be prescribed by the Government. The Securities Contracts (Regulation) Act empowers the Government also to withdraw the recognition granted to a stock exchange, in the interest of trade or in public interest. Further, in order to deal with abnormal and extraordinary situations which may develop from time to time, Government is empowered to supercede a governing body after giving an opportunity to the governing body to be heard in the matter and to appoint in its place any person or persons to perform the functions of the governing body; and to suspend such of the business of a stock exchange under certain circumstances, for such period not exceeding seven days as may be specified, in the interest of trade or in public interest. The period of suspension can be extended from time to time, but after the governing body has been given an opportunity of being heard in the matter.

Dealers and brokers dealing outside the area of the recognised stock exchange have to obtain licence from the Government.

Only members and their authorised clerks can enter the trading floor and conduct buying and selling of securities. There are brokers and other intermediaries who assist the buyers and sellers in their dealings.

Members: Membership is limited to Indian citizens. To become a member, one should be a major (i.e., should have attained the age of 21 years). In the past, only an individual (not a firm or company) could be a member. Recently, Government have permitted companies also to become members. Multiple membership, i.e., membership in more than one stock exchange is also permitted now.

Authorised Clerks: To assist the members for making transactions on the exchange, members are permitted to appoint a fixed number of authorised clerks. The number of authorised clerks varies from one exchange to another. For example, the Bombay Exchange permits five clerks per member whereas the Madras Exchange permits only three. The authorised clerks, as agents of the members, can enter the trading floor and buy or sell on behalf of their employers; but they cannot buy or sell on their own account.

Remisers: The remisers are sub-brokers employed by a member to secure business. The remisers are not permitted to enter the trading floor for exchange dealing. They are meant primarily to secure business from the outsiders. The remisers are very important in securing business because the share brokers are prohibited from making advertisement to solicit business.

Taravaniwalas and Brokers: Indian stock exchange has two categories of members namely Taravaniwalas and brokers. The Taravaniwala in India does the work similar to the *Jobber* in the London Stock Exchange. A jobber is a dealer in securities, while a broker is an agent of a buyer or seller of securities. Jobbers deal only with brokers and not with the public whereas the broker is a middleman between the jobber and the real buyer/seller. But Taravaniwalas in India have been found to play a double role of broker-cum-dealer.

Clearing House: It is an agency that performs the taks of arranging for delivery of securities and their payment by the concerned parties. The clearing house pools together all the bargains made by each member of the stock exchange so as to find out the result position and it traces the ultimate buyers and sellers of securities to put them in touch with each other. The clearing house thus simplifies and expedites the work.

REGULATION OF STOCK EXCHANGE

In India the development of the Stock market is directed and the dealings on the stock exchanges are regulated by the Central Government in accordance with the Securities Contracts (Regulation) Act, 1956 (SCRA), and the Securities and Exchange Board of India (SEBI) established by the Central Government.

Securities Contracts (Regulation) Act, 1956

The Securities Contracts (Regulation) Act, enacted in 1956, came into force on February 20, 1957.

Objectives of the Act

According to the preample to the SCRA, the objective of the Act is *to prevent undesirable transactions in securities* by:

(i) regulating the business of dealings in securities;

(ii) prohibiting options, and

(iii) providing for certain other matters connected with transaction in securities.

A pursual of the important provisions of the SCRA will indicate that the important objectives of the Act are:

(i) to empower the Central Government to regulate the dealings in and functioning of the stock exchange in India.

(ii) to promote healthy and orderly development of the stock market in India.

(iii) to prevent unhealthy speculation and other undesirable activities on the stock exchange.

(iv) to protect the interest of the investors.

(v) to provide for reasonable uniformity in respect of the bye-laws and rules of the different stock exchanges in India.

Main Provisions

The Securities Contracts (Regulation) Act, 1956, empowers the Central Government to take appropriate measures to achieve the objectives mentioned above. The important provisions of the Act encompass the authority given to the Central Government, or, in certain cases the SEBI, pertaining to:

(i) The grant of recognition or withdrawal of recognition to any stock exchange.

(ii) Approval of the bye-laws and rules of stock exchanges.

(iii) Power to direct the stock exchange to make or amend rules and bye-laws in certain cases.

(iv) Power to make or amend bye-laws or rules for stock exchanges.

(v) Monitoring the activities and functioning of the stock exchanges by calling for periodic returns and specific information as and when required and by conducting inquiry into certain matters when the situation so warrants.

(vi) Power to suspend business of stock exchanges.

(vii) Power to supersede governing body of any stock exchange on account of specific reasons.

(viii) Regulation of listing of securities.

Recognition to Stock Exchanges

After the coming into effect of the Securities Contracts (Regulation) Act, 1956, only those stock exchanges which are granted recognition by the Central Government can function in India.

Any stock exchange which is desirous of being recognised may apply to the Central Government in the prescribed manner with all the required particulars and a copy of the bye-laws of the stock exchange and the rules relating in general to the constitution of the stock exchanges and in particular to:

(i) the constitution and powers of the governing body and the manner in which its business is to be transacted;

(ii) the powers and duties of the office bearers of the stock exchange.

(iii) matters pertaining to membership such as eligibility for membership and related matters including expulsion and readmission of members;

(iv) the nomination and appointment of representative and clerks.

The Central Government may grant recognition to a stock exchange if it is satisfied that:

(i) The rules and bye-laws of the stock exchange are in conformity with such conditions as may be prescribed with a view to ensure fair dealing and to protect investors.

The conditions which the Central Government may prescribe in this respect may relate to (a) the qualifications for membership of the stock exchange (b) the manner in which contracts shall be entered into and enforced between members, (c) the representation of the Central Government on the stock exchange, and the maintenance of accounts of members and their proper audit.

(ii) The stock exchange is willing to comply with any other conditions which the Central Government may impose in accordance with the Act. These may also include conditions as to the number of members.

(iii) It would be in the interest of the trade and also in the public interest to grant recognition to the stock exchange.

The Act lays down that the Central Government shall not refuse grant of recognition to a stock exchange without giving it an opportunity to be heard and that the reasons for the refusal shall be communicated to the stock exchange in writing.

If the Central Government is of the opinion that the recognition granted to a stock exchange should be withdrawn in the interest of the trade or in the public interest, may do so after properly serving a notice on the governing body of the stock exchange and after giving the governing body an opportunity for being heard in the matter.

The amendments to the SCR Act by the Ordinance promulgated on January 25, 1995, provide for a Stock Exchange to establish additional trading floors with the prior approval of the SEBI.

Power to Obtain Information and to Conduct Inquiry

Every recognised stock exchange shall furnish the Central Government with a copy of the annual report containing all the particulars prescribed.

Further, every recognised stock exchange shall furnish to the SEBI such periodical returns relating to its affairs as may be prescribed.

It is also laid down by the Act that every recognised stock exchange and every member of such stock exchange shall maintain and preserve for such periods not exceeding five years such books of account and other documents as the Central Government may prescribe. These books of account and other documents shall be available for inspection by the SEBI at all reasonable time.

The SEBI is also authorised to call upon any recognised stock exchange or any member of such exchange to furnish any information or explanation relating to the affairs of the stock exchange or the member in relation to the stock exchange.

The SEBI is also empowered to order an inquiry in relation to the affairs of the governing body of a stock exchange or the affairs of any member of the exchange in relation to the stock exchange.

Rules of Stock Exchange

A recognised stock exchange may make rules or amend any rules made by it to provide for all or any of the following matters, namely.

(i) the restriction of the voting rights to members only in respect of any matter placed before the stock exchange at any meeting.

(ii) the regulation of the voting right in such a way that each member is entitled to have one vote only, irrespective of his share of the paid up capital of the stock exchange.

(iii) the restriction on the right of a member to appoint another person as his proxy to attend and vote at a meeting of the stock exchange and

(iv) any incidental, consequential and supplementary matters as may be necessary to give effect to any of the matters specified above.

The rules or amendments to the rules made by a stock exchange shall have effect only after they have been approved by the Central Government and published in the official Gazette. In approving the rules or amendments, the Central Government may make such modifications as it thinks fit.

The Act empowers the Central Government to order the stock exchanges in general or any stock exchange in particular to make or amend any rules pertaining to certain matters. The Government should consult with the governing bodies of the stock exchanges in general or with the governing body of the stock exchange concerned before issuing such as an order. While issuing the order to make or amend any rules, the Government shall also state the reasons for it.

If any stock exchange fails to comply with such an order within the specified period the Central Government may make or amend the rules as proposed earlier or with such modifications as may be agreed to between the stock exchange and the Central Government.

Bye-laws of Stock Exchanges

Any recognised stock exchange may, subject to the previous approval of the SEBI, make bye-laws for the regulation and control of contracts. These bye-laws will have effect from the date of publication after approved by the SEBI, in the official gazette, of the State in which the stock exchange is located.

The SEBI is empowered, on the basis of a request received from the governing body of a stock exchange or on its own motion, to make or amend any bye-laws in accordance with the SCRA.

Where the governing body of any stock exchange objects to any bye-laws made or amended by the SEBI on its own motion it may apply to the SEBI for a revision of it within specified period. After giving an opportunity to the governing body to be heard in the matter, the SEBI may revise the bye-laws so made or amended.

Power to Supersede Governing Body

If the Central Government has sufficient reasons to think that the governing body of any stock exchange should be superseded, it may do so after serving a written notice on the governing body and giving the governing body an opportunity to be heard in this matter. When the governing body is superseded the Government may appoint any person or persons to exercise and perform all the powers and duties of the governing body for such period as may be specified. The Government may vary this period, from time to time, by proper notification. The Central Government may call upon the stock exchange to reconstitute the governing body before the termination of this period.

Power to Suspend Business of Stock Exchange

The SCRA empowers the Central Government to suspend the business of any stock exchange, under certain circumstances, for a period not exceeding seven days in the interest of trade or public interest. The period of suspension may be extended from time to time but after the governing body has been given an opportunity of being heard in the matter.

Transferability and Registration of Transfer of Listed Securities

With a view to helping small investors against mala fide arbitrary refusal of companies of flimsy and unsubstantiated grounds, the Securities Contracts (Regulation) Act was amended in 1985, introducing a new Section, viz., Section 22-A, and making other consequential amendments in the Act. The main object of the amendment was to impart unrestricted transferability for securities of public limited companies which are listed on the Stock Exchange.

The new Section 22A(3), inserted by the Amendment Act, provides that notwithstanding anything contained in a Company's Articles of Association or in Sections 82 and 111 of the CompaniesAct, 1956, a company may refuse registration of any fully paid-up shares or debentures only on the following grounds, namely:

(i) that the instrument of transfer is defective or if the transfer form does not accompany the relevant certificate;

(ii) that the transfer is in contravention of any of the laws of the land;

(iii) that the proposed transfer would be likely to result in a change in the composition of the Board of Directors which would not be to the interests of the company or to the public interest;

(iv) that the transfer is prohibited by an order of the Court, tribunal or any other authority as per the provisions of any of the laws in force at that point of time.

Sub-section 4*(b)* of 22A provides that if the Board of Directors in good faith forms an opinion that the registration of securities is to be refused on account of defective instrument of transfer or non-accompaniement of the relevant certificate, it must, before the expiry of two months from the date of lodgement, intimate the transferer and transferee by notice in writing in the prescribed form indicating the requirements to be complied with for securing the transfer.

LISTING OF SECURITIES

Listing of securities refers to the sanction of the right to trade the securities on the stock exchange. There is no staturoty obligation that every public limited company should get its shares listed on a stock exchange, but only listed securities are allowed to be traded on a stock exchange. Any company desirous of mobilising resources from the capital market through a prospectus has to get its shares listed on at least one stock exchange, nearest to its registered office, known as the regional stock exchange. It is at the discretion of such a company to make an application to any other stock exchange. However, Section 21 of the Securities Contracts (Regulation) Act empowers the Government to compel any public limited company to have its securities admitted to dealings on a recognised stock exchange by requiring it to fulfil any conditions that may be prescribed in this behalf by the stock exchange concerned. Under Section 22 of the Act, a right of appeal to the Government is conferred on any public limited company which has been refused a quotation of its securities by a recognised stock exchange; the government may vary or set aside the decision of a stock exchange.

Listed securities are of two classes, viz., *Cash List* and *Forward List.* The securities on the cash list are those involving ready delivery while securities in the forward list enjoy forward trading privileges.

Advantages of Listing

Listing has some advantages:

(i) Listing enhances the marketability and liquidity of the security.

(ii) Another attractiveness of the listed securities is that they command higher collateral value for purpose of bank credit.

(iii) Listing lends prestige to the security and widens its market.

(iv) Listed securities enjoy more public confidence as the stock exchange compels the issuer to comply with high standards.

(v) Listing provides greater publicity for the company concerned because the prices and their trends in respect of the listed securities are often published by financial and business publications.

Listing Requirements and Obligations of Listed Companies

A company has to satisfy certain conditions for enlisting. Some of the Important conditions and obligations are:

(i) The Memorandum and Articles of Association of the company must contain prescribed provisions:

(ii) The company must offer for public subscription through a prospectus at least the prescribed minimum percentage of its issued capital;

(iii) The company should inform the exchange authorities about the details of the dividend distribution immediately after the Board meeting;

(iv) The company should give an undertaking to secure compliance with the provisions of the Companies Act and the Securities Contracts (Regulation) Act as well as the rules made thereunder:

(v) The company should notify to the stock exchange, without delay, of the date of the meeting of its Board of Directors at which the recommendations or declaration of a dividend or issue of rights or bonus shares, convertible debentures or the passing over the dividend is due to be considered. Information must be given to the stock exchange on the decision taken by the Board of Directors as referred to above;

(vi) Companies have to promptly forward to the exchange copies of the annual reports, notices, resolutions and circulars sent to the sharesholders in order that those investors who are not shareholders of the company should also be informed of the affairs of the company;

(vii) The company should publish, in a form approved by the stock exchange, such periodical interim statements of its working and earnings as it shall, from time to time, agree upon with the stock exchange;

(viii) The company shall keep the stock exchange informed of such events as strikes, lockout, closure on account of power cuts and so on, both at the time of occurrence of the events and subsequently after the cessation of events in order to enable the shareholders and the public to appraise the position of the company.

(ix) According to the Companies (Amendment) Act, 1988, a company intending to offer shares or debentures to the public for subscription by the issue of a prospectus shall, before such issue, make an application to one or more stock exchanges for permission for listing.

(Also see Appendix on SEBI Guidelines for Capital Issues)

SECURITIES AND EXCHANGE BOARD OF INDIA

The Securities and Exchange Board of India (SEBI) was constituted in 1988 under a resolution of the Government of India. It was later made a statutory body by the Securities and Exchange Board of India Act, 1992. According to this Act, the SEBI shall consist of a Chairman and five other members appointed by the Central Government (two members representing the ministries of Finance and Law, one member from the Reserve Bank of India and two other members).

With the coming into effect of the Securities and Exchange Board of India Act, 1992, some of the powers and functions exercised by the Central Government, in respect of the regulation of the stock exchanges were transferred to the SEBI.

Objectives and Functions of SEBI

According to the SEBI Act, it shall be the duty of the SEBI to take suitable measures:

(i) to protect the interests of investors in securities; and

(ii) to promote the development of and to regulate the securities market

Such measures may provide for

(i) regulating the business in stock exchanges and any other securities markets;

(ii) registering and regulating the working of stock brokers, sub-brokers, share transfer agents, bankers to an issue, trustees of trust deeds, registrars to an issue, merchant bankers, underwriters, portfolio manager, investment advisers and such other intermediaries who may be associated with securities markets in any manner;

(iii) registering and regulating the working of collective investment schemes, including mutual funds;

(iv) promoting and regulating self-regulatory organisations;

(v) promoting investors' education and training of intermediaries of securities markets;

(vi) prohibiting insider trading in securities;

(vii) regulating substantial acquisition of shares and takeover of companies;

(viii) calling for information from, undertaking inspection, conducting inquiries and audits of the stock exchanges and intermediaries and self regulatory organisations in the securities market;

(ix) performing such functions and exercising such powers under the provisions of the Capital Issues (Control) Act, 1947 and the Securities Contracts (Regulation) Act, 1956, as may be delegated to it by the Central Government;

(x) levying fees or other charges for carrying out the purposes of this section;

(xi) conducting research for the above purposes;

(xii) performing such other functions as may be prescribed.

Powers of Central Government

The SEBI Act lays down that, in exercise of its powers or the performance of its functions, the Board shall be bound by the directions of the Central Government on questions of policy. However, before any such direction is given, as far as possible the Board shall be given an opportunity to express its views.

The Act also empowers the Central Government to supersede the SEBI if it is of the opinion (i) that on account of grave emergency the Board is unable to discharge its duties and function, or (ii) that the Board has persistently made default in complying with any direction issued by the Government or in the discharge of its functions and duties or (iii) that circumstances exist which render it necessary in the public interest to do so.

The period of supersession shall not exceed six months. The Central Government may reconstitute the Board before or on the expiration of the prior of supersession.

Amendments to SEBI Act

The Government has, on 25 January, 1995, promulgated an Ordinance to amend the Securities and Exchange Board of India Act, 1992 so as to arm the Securities and Exchange Board of India (SEBI) with additional powers for ensuring the orderly development of the capital market and to enhance its ability to protect the interests of the investors.

To enable SEBI to respond speedily to market conditions and to reinforce its autonomy. SEBI has also been empowered to file complaints in courts without the prior approval of the Central Government, and to notify its Regulations without the prior approval of the Central Government.

The amendments provide SEBI with regulatory powers over corporates in the issuance of capital, the transfer of securities and other related matters. It has also been empowered to impose monetary penalties on capital market intermediaries and other participants for a listed range of violations. Hitherto, the SEBI Act provided for the suspension and cancellation of registration and prosecution of intermediaries. As suspension and cancellation lead to the stoppage of business, often adversely affecting others who have had business, with the affected intermediary, monetary penalties constitute an alternative mechanism for dealing with capital market violations. It is proposed to create an adjudicating mechanism within SEBI for levying penalties and it is also proposed to constitute a separate Tribunal to deal with cases of appeal against orders of the adjudicating authority. The appellate authority against orders of the Tribunal will be High Courts.

OTC EXCHANGE OF INDIA

The establishment of the Over The Counter Exchange of India (OTCEI) marked the dawn of a new era in the history of stock exchanges in India. The PTC Exchange is a blessing for the small, both existing and new, companies and for investors, particularly small investors.

The OTCEI is meant primarily to trade securities of the listed companies, like the other stock exchanges. It is, however, a stock exchange with a lot of differences with those of other. "Although the basic framework of the OTC Exchange is that of a *national market, yet there is no physical location, no counters, no trading ring, no stock exchange building and no hustle and bustle scenes as the conventional stock exchanges.* The buyers and sellers living apart from each other trade in corporate securities over the telephone. The system cuts across urban and rural areas extending the frontiers of the stock market to the entire country. These OTC markets are fully automated exchanges where transactions are completed through a network of telephones/tellers computers right from the first centre to the last centre. In addition, only professional people are authorised to render financial services."[4]

The OTCEI has been promoted jointly by ICICI, UTI, IFCI, IDBI, SBI Capital Markets Ltd., Canara Bank Financial Services Ltd., GIC and LIC. These institutions are sponsor members of this Exchange.

Over The Counter basically implies trading across the counter in scrips which are listed on the OTC exchange.

The term *counter* refers to the location of the member or a dealer of the OTCEI where dealing actually takes place. All the counters trade in all the scrips listed on the OTC Exchange. At every counter, an investor can see the quotes on the PTI - OTC Scan, complete a transaction, as well as ask for investor services. In other words, each counter acts as a trading floor of the OTCEI. Thus, as against a single trading floor in a regular stock exchange, there would be as many trading floor as the number of counters on the OTC Exchange.

Initially the operations of the OTC Exchange would cover all cities/towns where there are Stock Exchanges and later they would be extended to other places.

In an OTC Exchange, the investor walks up to the Counter, see the prices on the OTC scan and decides to buy/sell. The process and procedures for buying/selling are very simple. To buy, the investor makes payment by cheque or receives a temporary Counter Receipt (CR)*. When the cheque is cleared he returns the temporary CR and collects the final CR. The deal is now complete.

One who sells the scrips delivers the CR and Transfer Deed (TD) at the counter and receives a Sales Confirmation Slip(SCS). When the CR and TD are cleared, he returns the SCS and collects the cheque.

---

[4] V.A. Avadhani, Investment and Securities Markets in India (Bombay: Himalaya Publishing House, 1992), p. 222.

* Investors on the OTC Exchange trade with the document Counter Receipt (CR) instead of Share Certificates (SC). That is, when an investor gets allotment in a public issue he is issued with a CR, not a SC. When an investor wants to sell his shares, he will have to exchange it for CR. As the CR is sufficient proof of ownership of the shares of a company, it is not necessary for an investor to exchange it against a share certificate unless otherwise required for any specific purpose.

Listing on the OTCEI

The minimum issued equity capital of a company for eligibility for listing on the OTCEI is Rs. 30 lakhs, subject to a minimum public offer of equity shares worth Rs. 20 lakhs. For companies with an issued equity capital of more than Rs. 30 lakhs but less than Rs. 300 lakhs, the minimum public offer should be 40 per cent of the issued capital or Rs. 20 lakhs worth shares in face value, whichever is highest. Companies with an issued equity capital of more than Rs. 300 lakhs seeking listing on the OTCEI will have to comply with the listing requirements and guidelines as are applicable to such companies for enlistment on other recognised Stock Exchanges.

Any company which wants to list its shares on the OTCEI will have to be sponsored by a sponsor. The responsibilities of the sponsors include appraising the project/company properly, valuing the scrip fairly and promoting its sales. One of the main functions of the sponsor is *market making,* i.e., giving two way (both buy and sell) quotes for the scrip concerned. The sponsor has to do *compulsory market making* for at least three years from the date trading commences. This is intended to provide enforced liquidity for investors. After a period of three years, the sponsor will continue to make market in the scrip till an alternative market maker is arranged for. A sponsor, who is the *compulsorymarket maker* (CMM) may appoint *additional market maker* (AMM) or dealer. An AMM has to make market in the scrip for atleast one year continuously.

Both members and dealers can act as *voluntary market makers* (VMMs) on the OTC Exchange. An VMM has to make market in a scrip for atleast three months continuously.

A company listed on any other recognised stock exchange in India would not simultaneously be eligible for listing on the OTCEI.

Companies which are engaged in investments, leasing, finance, hire purchase, amusement parks, etc. are not eligible for listing on the OTEEI.

Distinguishing Features

The OTCEI has a number of distinguishing features vis-a-vis other Stock Exchanges.

(i) While other stock exchanges are associations formed by stock brokers, the OTCEI is a company promoted by financial institutions.

(ii) As described in the preceding section, there are many restrictions on listing on the OTCEI. Several types and categories of companies which are not eligible for listing on a regular Stock Exchange are not eligible on the OTCEI. Further, a company listed on any other recognised stock exchange in India would not simultaneously be eligible for listing on the OTC Exchange.

(iii) The method of price fixation differs between the OTCEI and other Exchanges. On the OTC Exchange the pricing of scrips is regulated. The market makers compulsorily offer buy-sell quotes which are based on proper evaluation of the company. In other Stock Exchanges, the share prices need not necessarily have any relation to the fundamentals. Speculation could cause wide price fluctuations on the regular Exchanges.

(iv) The OTC Exchange is a market for spot deals only.

(v) On the OTCEI, the settlement takes place daily, unlike on the other exchanges where it is normally fornightly or weekly.

(vi) The OTC Exchange permits automatic transfer upto 0.5 per cent of a company's equity whereas in other cases permission of the companies is required for all transfers.

(vii) In the OTC Exchange, the spread does not exceed a specified percentage whereas in a volatile market there is no restriction on spreads.

(viii) The OTCEI is characterised by a decentralised working with a national work. Other exchanges are centralised in nature, members operating from a single location.

Benefits to the Investors

The OTC Exchange offers a number of benefits to the investors. The important advantages of it from the point of view of the investors are:

(i) Quick payment of money to the sellers and quick delivery of shares to buyers.

(ii) Price transparency: On the OTCEI, the investor clearly knows the buying and selling prices whereas he is not able to know the actual price at which the scrips are bought or sold for him in other stock exchanges.

(iii) The OTCEI saves the investors from other unscrupulous behaviour of the brokers.

(iv) Liquidity even for scrips of small and new companies.

(v) Fair prices.

(vi) Simple procedure of buying and selling

(vii) Facility to sell even odd lots.

---

* For more information about the OTC Exchange refer V.A. Avadhani, *Investment and Securities Markets in India* (Himalaya Publishing House, Bombay)

Benefits to the Companies

The OCT Exchange offers certain advantage to the companies also. The important benefits to the companies are:

(i) Enables even smaller and less liquid companies to get listed.

(ii) Facilitate new issues at lower costs.

(iii) Makes raising capital through issues eay for small, new and closely held companies.

(iv) Helps create market for scrips of small and new companies.

NATIONAL STOCK EXCHANGE OF INDIA

The National Stock Exchange of India (NSEI) was established in 1994 by financial institutions and banks with IDBI as a nodal agency.

Many secondary market problems can only be completely solved by introducing scripless trading and de-materialisation of scrips in depositories. A beginning in this respect was made with the establishment of the NSEI.

The NSEI is conceived as a model exchange with a nation-wide electronic screen based "Scripless" and "floorless" trading system in securities which will be both efficient and transparent and offer equal and nation-wide access to investors.

The National Stock Exchange is to operate in two different segments, viz,

(i) Wholesale Debt Market, (WDM), and

(ii) Capital Market (CM).

The WDM is concerned with trading in instruments like Government Securities, PSU bonds, units 64 of UTI, CDs and CPs by corporate entities (like banks, institutions, brokerage houses).

The CM is concerned with equity and corporate debt instruments by both corporate entities and individuals. It will encourage high net worth corporate trading members with dealer network and short settlement cycles.

Although formally inaugurated only in July 1994, the NSEI commenced operations in the WDM in June 1994 and trading in equities in the CM segment in November 1994.

The RBI has directed banks to use only the NSEI for all transactions in debt securities, done earlier through brokers, to ensure transparency and facilitate regulation (in place of the unregulated telephone market).

As a national exchange, the NSEI has set fairly stringent criteria for membership in terms of net worth, education and experience, to ensure that trading members are well capitalised and can provide other services to investors.

Initially, the NSEI opened membership to 13 cities, the operations are to cover the entire nation in due course using the satellite network.

There is a feeling that the functioning of the National Stock Exchange would weaken the Bombay Stock Exchange or other Exchanges. However, the NSEI should be viewed as an important step in providing efficient and transparent services to investing public. It may affect other Exchanges if they fail in providing transparency and efficiency. In fact, the operations of NSEI is expected to act as a spur for the modernisation of the Bombay Stock Exchange Online Trading (BOLT) system for introducing screen based trading system. The Bombay Stock Exchange has also taken the initiative for the establishment of a National Stock Market System (NSMS) for providing improved services to investors all over the country. Eventually the NSEI and other Stock Exchanges should compete in minimising transaction cost and in providing fair services to investors.

APPENDIX

GUIDELINES FOR CAPITAL ISSUES

Capital issues had been controlled by the Controller of Capital Issues (CCI) under the Capital Issues Control Act. Prior permission of the CCI was required for capital issues. The pricing of the issues was also controlled by the CCI.

As a part of the economic policy reforms, the Capital Issues Control Act was repealed and the office of the CCI was abolished. Subsequently, the Securities and Exchange Board of India (SEBI) have, issued guidelines for issue of capital, substantially liberalising capital issues and pricing of the issues.

According to the guidelines, a new company can freely price its capital issues subject to a few conditions.

Existing private/closely held companies with a three year track record of consistent profitability can freely price the issue and list their securities on the stock exchanges.

The Guidelines, however, impose certain restrictions on bonus issues. Bonus issue within one year of earlier issue is not permitted. Further, bonus issue in lieu of dividend is prohibited.

Full underwriting is made mandatory.

The guidelines require the companies to make adequate disclosures to the SEBI.

The Text of the SEBI Guidelines is given below:

First Issue of Companies

(a) A new company will be defined as one which has not completed 12 months of commercial operations and its audited operative results are not available, and where it is set up by entrepreneurs without a track record. They will be permitted to issue capital to public at par.

Where a new company is being set up by existing companies with a five-year track record of consistent profitability, it will be free to price its issue provided the participation of the promoting company and the issue price is made applicable to all new investors uniformly, provided that the prospectus or offer documents shall contain justification for issue price.

A draft prospectus containing the disclosures will be vetted by Securities and Exchange Board of India (SEBI) before a public issue is made.

No private placement of the promoters share shall be made by solicitation of share contribution from unrelated investors through any kind of market intermediaries. The share of the above companies can be listed on either the Over the Counter Exchange of India or any other stock exchange.

First Issue by Existing Private/Closely held Companies

(i) Such companies with a three year track record of consistent profitability shall be permitted to freely price the issue and list their securities on the stock exchanges.

(ii) Not less than 20 per cent of the equity should be offered.

(iii) The draft prospectus will be vetted by SEBI to ensure adequacy of disclosures.

(iv) The pricing would be determined by the issuer and lead managers to the issue and would be subject to specific disclosure requirements including:

(a) disclosures of the net asset value of the company as per the last audited balance sheet.

(b) justification for the issue price.

Public Issue by Existing Listed Companies

(a) These companies will be allowed to raise fresh capital by freely pricing their further issues.

(b) Pricing — the issue price will be determined by the issuer in consultation with the lead manager (s) to the issue.

(c) Disclosures —

(i) the draft prospectus will be vetted by SEBI to ensure adequacy of disclosures.

(ii) the prospectus or offer documents shall contain the net asset value of the company and a justification for the price of the issue.

(iii) high and low price of the shares for the last two years.

Underwriting

(a) Underwriting is mandatory for the full issue and minimum requirement of 90 per cent subscription is also mandatory for each issue of capital to the public. Number of underwriters would be decided by the issuers.

(b) If the company does not receive 90 per cent of issued amount from public subscription plus accepted devolvement from underwriters, within 120 days from the date of opening of the issue, the company shall refund the amount subscription. In case of disputed development, the company should refund the subscription if the above conditions are not met.

(c) The lead manager (s) must satisfy themselves about the net worth of the underwriters and outstanding commitments and disclose the same to SEBI.

(d) The underwriting agreements may be filed with the stock exchange.

Composite Issues

Issues to the public by existing company can be priced differentially as compared to the issues to the rights shareholders.

Fully Convertible Debentures/Partially Convertible Debentures/Non-Convertible Debentures

(a) Issue of FCDs having a conversion period more than 36 months will not be permissible, unless conversion is made optional with "put " and "call" option.

(b) Compulsory credit rating will be required if conversion is made for FCDs after 18 months.

(c) Premium amount on conversion, time of conversion, in stages, if any, shall be pre-determined and stated in the prospectus. This interest rates for above debentures will be freely determined by the issuer.

(d) Issue of debentures with maturity of 18 months or less are exempt from the requirement of appointment of Debenture Trustee or creating a Debenture Redemption Reserve (DRR). In other cases, the names of the debenture trustees must be stated in the prospectus and DRR will be created in accordance with Section (N.1). The trust deed shall be executed within six months of the closure of the issue.

(e) Any conversion in part or whole of the debenture will be optional at the hands of the debenture holder, if the conversion takes place at or after 18 months from the date of allotment, but before 36 months.

(f) In case of NCDs/PCDs credit rating is compulsory when maturity exceed 18 months.

(g) Premium amount at the time of conversion for the PCD shall be pre-determined and stated in the prospectus. Redemption amount, period of maturity, yield on redemption for the PCDs/NCDs shall be indicated in the prospectus.

(h) The discount on the non-convertible portion of the PCD in case they are traded and procedure for their purchase on spot trading basis must be disclosed in the prospectus.

(i) In case, the non-convertible portions of PCD/NCD are to be rolled over with or without change in the interest rate a compulsory option should be given to those debentureholders who want to withdraw and encash from the debenture programme. Roll over shall be done only in case where debentureholders have sent their positive consent and not on the basis of their negative reply.

(j) Before roll over of any NCD or non-convertible portion of the PCDs, fresh credit rating shall be obtained within a period of six months prior to the due date of redemption and communicated to debentureholders before roll over and fresh trust deed shall be made.

(k) Letter of information regarding roll over shall be vetted by SEBI with regard to the credit rating, debentureholder resolution, option for conversion and such other items which SEBI may prescribe from time to time.

(l) The disclosure relating to raising of debentures will contain amongst other things, the existing and future equity and long term debt ratio, servicing behaviour on existing debentures, payment of due interest on due dates on term loans and debentures, certificate from a financial institution or bankers about their non-objection for a second or *pari passu* charge being created in favour of the trustees to the proposed debenture issues.

(m) SEBI may prescribe additional disclosure requirement from time to time, after due notice.

New Financial Instruments

Issuer of capital shall make adequate disclosures regarding the terms and conditions of redemption, security, conversions and any other relevant features of–

instruments such as Deep Discount Bonds, Debentures with Warrants, Secured premium notes etc. so that an investor can make reasonable determination of the risks, returns, safety and liquidity of the instruments. The disclosures shall be vetted by SEBI in this regard.

Reservation in Issues

(a) Unreserved offer of equity or instruments convertible into equity shall not be less than the minimum required for listing purposes in case of new issues made either by the new company or by the existing closely held private companies going public.

(b) In case of issues of capital by new companies, reservations for employees of new companies, promoting companies, associate companies, working directors on a suitable percentage is permissible.

(c) Shareholders of group companies in case of existing companies can be offered capital on a preferential basis.

(d) Shareholders of promoters' companies shall also be eligible for preferential allotment.

(e) Reservations for NRIs shall be according to the schemes prescribed by RBI from time to time.

Deployment of Issue Proceeds

(a) In case of issues, where on application and on allotment an amount together exceeding Rs. 250 crores is raised, the issuer will voluntarily disclose and make arrangements for the use of proceeds of the issue as per disclosure to be monitored by one of the financial institutions. A copy of their monitoring report shall be filed with the SEBI by the institutions and by the company for purposes of record.

(b) In issue of the above size and beyond, the amount to be called up on application/allotment and on various calls should not exceed 25 per cent of the total quantum of issue.

Minium Interval Time Between Two Issues

(a) No bonus issue shall be made within 12 months of any public/rights issue.

(b) The promoters shall bring in capital in full before public issue.

(c) The capital issue should be made fully paid on within 12 months from the date of issue.

Employee Stock Option Scheme

This is a voluntary scheme on the part of the company to encourage employees to have higher participation in the company. Suitable percentage of reservation can be made by the issuer for the employees of his company or the promoters of the company as the need may arise. Reservation should not be more than five per cent. Equitable distribution of shares among the employees will contribute to the smooth working of the scheme. The issuer may like to have non-transferability at his discretion in new issues. In other cases, employees' participation upto five per cent (maximum 200 shares) shall be non-transferable for a period of three years.

Promoters' Contribution and Lock in Period

(a) Equity capital to be subscribed in any issue to the public by the promoters, i.e., those described in the prospectus as promoters, directors, friends, relatives and associates should not be less than 25 per cent of the total issue of equity capital upto Rs. 100 crores and 20 per cent of the issues above Rs. 100 crores. In the case of FCDs, one third of the issue amount should be contributed by promoters, directors, friends, relatives and associates by way of equity before issue is made. In case of PCDs, one third of the convertible portion should be brought in as contribution of promoters, directors, friends, and relatives and associates before issue is made. Minimum subscription by each of the friends/relatives and associates under promoters quota should not be less than Rs. 1 lakh.

(b) This promoters' contribution shall not be diluted for a lock in period of five years from the date of commencement of the production or date of allotment whichever is later. Promoters must bring in their full subscription to issues in advance before public issue.

(c) All firm allotments, preferential allotments to collaborators, shareholders of promoter companies whether corporate or individual shall not be transferable for three years from the date of commencement of production or date of allotment whichever is later.

(d) The share certificate issued to promoters, friends, relatives and associates etc. should carry the inscription "not transferable" for a period three to five years as may be applicable from the date of commencement of production of date of allotment whichever is later.

Bonus Shares

Subject to the proviso to Sec. J(a) above, the company shall, while issuing bonus shares, ensure the following:

(a) the bonus issue is made out of free reserves built out of the genuine profits or share premium collected in cash only;

(b) reserves created by revaluation of fixed assets are not capitalised;

(c) the development rebate reserve or the investment allowance reserve is considered as free reserve for the purpose of calculation of residual reserves test only;

(d) all contingent liabilities disclosed in the audited accounts which have bearing on the net profits, shall be taken into account in the calculation of the residual reserves;

(e) the residual reserves after the proposed capitalisation shall be at least 40 per cent of the increased paid up capital;

(f) 30 per cent of the average profits before tax of the company for the previous three years should yield a rate of dividend on the expanded capital base of the company at 10 per cent;

(g) the capital reserves appearing in the balance sheet of the company as a result of revaluation of assets or without accrual of cash resources are neither capitalised nor taken into account in the computation of the residual reserves of 40 per cent for the purpose of bonus issues;

(h) the declaration of bonus issue, in lieu of dividend, is not made;

(j) the company: (1) has not defaulted in payment of interest or principal on redemption thereof and (2) has sufficient reason to believe that it has not defaulted in respect of the payment of statutory dues of the employees such as contribution to provident fund, gratuity, bonus etc.;

(k) a company which announces its bonus issue after the approval of the Board of Directors must implement the proposals within a period of six months from the date of such approval and shall not have the option of changing the decision;

(l) there should be a provision in the Articles of Association of the company for capitalisation of reserves etc. and and if not, the company shall pass a Resolution at its General Body Meeting making provisions in the Articles of Association for capitalisation;

(m) consequent to the issue of bonus shares if the subscribed and paid up capital exceed the authorised share capital, a resolution shall be passed by the company at its general body meeting for increasing the authorised capital;

(n) the company shall get a resolution passed at its general body meeting for bonus issue and in the said resolution the management's intention regarding the rate of dividend to be declared in the year immediately after the bonus issue should be indicated;

(o) no bonus issue shall be made which will dilute the value or rights of the holders of debentures, convertible fully or partly.

GUIDELINES FOR THE PROTECTION OF THE INTEREST OF DEBENTUREHOLDERS

Servicing of Debentures

Subject to provisions of Section F, a debenture redemption reserve (DRR) shall be created by all the companies raising debentures on the following basis:

(a) A moratorium upto the date of commercial production can be provided for creation of the debenture redemption reserve in respect of debentures raised for project finance.

(b) The debentures redemption reserve may be created either in equal instalments for the remaining period or higher amounts if profits permit.

(c) In the case of partly convertible debenturs, DRR should be created in respect of non-convertible portion of debenture issue on the same lines as applicable for fully non-convertible debenture issue. In respect of convertible issues by new companies, the creation of DRR should commence from the year the company earns profits for the remaining life of debentures.

(d) Companies may distribute dividends out of general reserves in certain years if residual profits after transfer to DRR are inadequate to distribute reasonable dividends.

(e) DRR will be treated as a part of General Reserve for consideration of bonus issue proposals and for price fixation related to post tax return.

(f) In case of new companies, distribution of dividend shall require approval of the trustees to the issue and the lead institution, if any.

(g) Company should create DRR equivalent to 50 per cent of the amount of debenture issue before debenture redemption commences. Drawal from DRR is permissible only after 10 per cent of the debenture liability has been actually redeemed by the company.

(h) In the case of existing companies prior permission of the lead institution for declaring dividend exceeding 20 per cent or as per the loan convenants is necessary if the company does not comply with institutional condition regarding interest and debt service coverage ratio.

(i) Company may redeem debentures in greater number of instalments. The first instalment may start from 5th instead of 7th year.

Protection of Debentureholders' Interest

(a) Trustees to the debenture issue shall be vested with the requisite powers for protecting the interest of debentureholders including a right to appoint a nominee director on the Board of the company in consultation with institutional debentureholders.

(b) Lead institution/investment institution will monitor the progress in respect of debentures for project finance/modernisation/expansion/diversification/normal capital expenditure. The lead bank for the company will monitor debentures raised for working capital funds.

(c) Institutional debentureholders and trustees should obtain a certificate from the company's auditors in respect of utilisation of funds during the implementation period of projects. In the case of debentures for working capital, certificate should be obtained at the end of each accounting year.

(d) Debeture issues by companies belonging to the groups for financing replenishing funds or acquiring shareholding in other companies will not be permitted.

(e) The companies shall, along with their application, file with SEBI certificate from their bankers that the assets on which security is to be created are free from any encumbrances and the necessary permissions to mortgage the assets have been obtained or a No Objection Certificate from the financial institutions or banks for a second or *pari passu* change in cases where assets are encumbered. The security should be created within six months from the date of issue of debentures. If for any reasons the companies are not in a position to create security within 12 months from the date of issue of debentures the company shall be liable to pay 2 per cent penal interest to debentureholders. If security is not created even after 18 months, a meeting of the debentureholders should be called within 21 days to explain the reasons thereof and the date by which the security would be created.

(f) The trustees to the debentureholders will supervise the implementation of the conditions regarding creation of security for the debentures and regarding the debenture redemption reserve.

General

(a) Subscription list for public issues should be kept open for at least 33 working days and disclosed in the prospectus.

(b) Rights issues should not be kept open for more than 60 days.

(c) The quantum of issue, whether through a right or public issue, shall not exceed the amount specified in the prospectus/letter of offer. No retention of over subscription is permissible under any circumstances.

(d) Within 45 days of the closures of an issue a report in a prescribed form with a compliance certificate from the Chartered Accountants should be forwarded to SEBI by the lead managers.

(e) The gap between the closure dates of various issues, e.g., rights and Indian public should not exceed 330 days.

(f) In case of issues of debentures fully or partly made in the past, when the conversion was to be made at a price to be determined by the Controller of Capital Issues at a later date, the price of coversion and time of conversion shall be determined by the company in a duly organised meeting of the debentureholders and shareholders. The decision in the above meeting may be ratified by the shareholders in their meeting. Such conversions will be optional for acceptance on the part of individual debentureholders. The dissenting debentureholders shall have the right to continue as debentureholders if the terms of conversion are not acceptable to them. The letter of option to debentureholders should be vetted by SEBI.

(g) SEBI will have the right to prescribe further guidelines for modifying the existing ones to bring about adequate investor protection, enhance the quality of disclosures and to bring about transparency in the primary market.

(h) SEBI shall have the right to issue necessary classification to these guidelines to remove any difficulty in its implementation.

(i) Any violation of the guidelines by the issues/intermediaries will be punishable by prosecution by SEBI under Act.

(j) The provisions in the Companies Act, 1956 and other applicable laws shall be complied with in connection with issue of shares and debentures.

24

Industrial Finance

Finance, which has been aptly described as the "life-blood" of industry, is a pre-requisite for the mobilisation of real resources to organise production and marketing. Depending upon the nature of the activity to be financed, business requires short-term, medium-term and long-term finance.

Short-term Finance

Short-term finance usually refers to the funds required for a period of less than one year. Short-term finance is usually required to meet variable, seasonal or temporary working capital requirements.

Borrowing from banks is a very important source of short-term finance. Other important sources of short-term finance are trade credit, instalment credit and customer advances.

Medium-term Finance

The period of one year to five years may be regarded as a medium-term. Medium-term finance is usually required for permanent working capital, small expansions, replacements, modifications, etc.

Medium-term finance may be raised by :

(i) Issue of shares;

(ii) Issue of debentures;

(iii) Borrowing from banks and other financial institutions; and

(iv) Ploughing back of profits (by existing concerns).

Long-term Finance

Periods exceeding 5 years are usually regarded as long-terms. Long-term finance is required for procuring fixed assets, for the establishment of a new business, for substantial expansion of existing business, modernisation, etc.

The important sources of long-term finance are :

(i) Issue of shares;

(ii) Issue of debentures;

(iii) Loans from financial institutions; and

(iv) Ploughing back of profits (for existing concerns).

SOURCES OF FINANCE

	Short-Term		*Medium-Term*		*Long-Term*
(i)	Bank credit	(i)	Issue of shares	(i)	Issue of shares
(ii)	Trade credit	(ii)	Issue of debentures	(ii)	Issue of debentures
(iii)	Instalment credit	(iii)	Loans from banks and other financial institutions	(iii)	Loans from financial institutions
(iv)	Customer advances	(iv)	Public deposits (for existing concerns)	(iv)	Ploughing back of profits (for existing concerns)
		(v)	Ploughing back of profits (for existing concerns)		

CORPORATE SECURITIES

Corporate securities are instruments by which capital is raised by joint stock companies. There are two classes of corporate securities, namely :

(i) Ownership securities; and

(ii) Creditorship securities.

OWNERSHIP SECURITIES

Ownership securities are the *shares* by which the *owned capital* (also known as *risk capital* and *venture capital*) is raised.

Kinds of Shares

The shares of a company may be broadly divided into :

(a) Preference Shares, and

(b) Equity Shares.

Preference Shares

Preference shares are those which have preferential right to the payment of dividend during the life-time of the company, and a preferential right to the return of capital when the company is wound up.

Perference shares have the following characteristics :

(i) The dividend on them is fixed by the Articles of the company;

(ii) Preference shareholders get their fixed rate of dividend before any dividend is distributed among the other class of shareholders;

(iii) At the time of winding up the company, the preference shareholders must be paid back their capital before anything is paid to ordinary shareholders.

Kinds of Preference Shares

(i) *Cumulative Preference Shares :* The cumulative preference shares are entitled to fixed dividends whether there are profits or no profits. If profits are not sufficient to pay dividends in a particular year, the dividends are accumulated and paid in the succeeding year(s) as profits become available for distribution.

(ii) *Non-cumulative Preference Shares :* Unlike the cumulative preference shares, these shares cannot claim arrears of dividends of any year out of the profits of subsequent years.

(iii) *Participating Preference Shares :* In the case of the participating preference shares, shareholders receive a fixed rate of dividend in priorty to ordinary shares and, further, the right to participate in the balance of profit in an agreed proportion together with ordinary shareholders.

(iv) *Non-participating Preference Shares :* These shares are entitled to only a fixed rate of dividend ; they have no claim in the surplus profit which belongs to ordinary shareholders.

(v) *Redeemable Preference Shares :* These are shares which can be purchased back by the company. The company reserves its right to call back or purchase these shares at any time, subject to the provisions of its Articles.

(vi) **Irredeemable Preference Shares :** These are shares that cannot be purchased back by the company.

Equity Shares

All shares which are not preference shares are equity shares, also called ordinary shares. Unlike the preference share, equity shares do not have a fixed rate of dividend. Equity shareholders are entitled to dividends only after the dividend claims of the preference shareholders have been met. Similarly, at the time of the winding up of the company, equity shareholders get back their capital only after the capital of the preference shareholders has been paid back. Equity shares are always irredeemable and their holders have normal voting rights.

Recent Developments

Convertible Cumulative Preference Shares: In 1985, Government of India introduced a new type of preference share namely convertible cumulative preference (C C P) share. The entire issue of the C C P shares shall be converted to equity any time between the third and fifth year of the issue. Since the conversion to the equity is compulsory, the C C P shares cannot be redeemed at any stage. The C C P shareholders enjoy the same voting rights as the cumulative preference shareholders. For calculation of debt equity ratio, C C P shares are treated as part of equity. However, for calculation of preference-equity ratio, C C P shares are totally excluded from both categories.

Companies (Amendment) Act, 1988: The above Act inserted a new sub-section, 80A, to the Companies Act, 1956. According to this sub-section:

(a) Irredeemable preference shares issues before the commencement of this Amendment Act shall be redeemed by the company within a period of five years from the commencement of this Amendment.

(b) Preference shares which are not redeemable before the expiry of 10 years from the date of issue and which had not been redeemed before the commencement of this Amendment Act, shall be redeemed on the due date or within a period of 10 years from the commencement of the Amendment, whichever is earlier.

Where a company is not in a position to redeem any such share within the period aforesaid and to pay the dividend, if any, due thereon, it may, with the consent of the Company Law Board (CLB) issue further redeemable preference shares equal to the amounts due (including the dividend) in respect of the unredeemed preference shares, and on the issue of such further redeemable preference shares, the unredeemed shares shall be deemed to have been redeemed.

Alteration of Share Capital

Section 94 of the Companies Act provides that a limited company can, if permitted by its Articles of Association, alter its share capital in any of the following ways :

(i) It may increase its share capital by the issue of new shares;

(ii) It may consolidate and divide all or any part of its share capital into shares of a larger amount;

(iii) It may convert all or any of its fully paid-up shares into stock or reconvert that stock into fully paid-up shares;

(iv) It may subdivide the existing shares into shares of lower denomination; and

(v) It may cancel those shares which have not been taken up and reduce its capital accordingly.

Any of the above alterations can be effected by passing a resolution in the general meeting of the company and requires no confirmation by the court. However, the company shall give notice of any such alterations to the Registrar within thirty days after doing so.

CREDITORSHIP SECURITIES

Creditorship securities which consist of debentures and bonds, are credit instruments which are widely used by companies to raise funds. The capital raised through creditorship securities is known as borrowed capital or debt capital.

Debentures

The term *debenture* is defined as "a document under the company's seal which provides for the payment of a principal sum and interest thereon at regular intervals which is usually secured by a fixed or floating charge on the company's property or undertaking which acknowledges a loan to the company."

Classes of Debentures

(i) *Redeemable and Irredeemable* : From the point of view of redemption, debentures are classified into redeemable and irredeemable. Redeemable debentures are those that will be repaid by the company at the end of a specified period, or on demand, or by instalments. Irredeemable debentures are those that are not repayable during the life-time of the company. Irredeemable debentures are also called perpetual debentures.

(ii) *Mortgage and Simple* : From the point of view of security, debentures are classified into mortgage and simple or naked debentures. Mortgage debentures, also called secured debentures, are those which are secured by a charge on the assets or property of the company, whereas simple debentures are those that are not secured by any charge on the assets of the company.

(iii) *Registered and Bearer* : From the point of view of records, debentures may be classified into registered and bearer debentures. Registered debentures are those in respect of which the names, addresses and particulars of the holdings of debenture-holders are entered in the Register of Debenture-holders. The transfer of a registered debenture cannot be effected without the execution of a regular transfer deed. As against this, the company keeps no such records of bearer debenture-holders. Bearer debentures are negotiable by mere delivery of the document.

(iv) *Convertible and Unconvertible* : In case of convertible debentures, the holders have the option to convert their debenture holdings into equity shares of the company at a specified rate after a specified period.

NEW ISSUES —MARKETING OF SECURITIES

The securities market may be divided into :

(i) New Issues Market ; and

(ii) Stock Exchange.

The new issues market is concerned with the floatation of new issues of securities either by new corporations or by existing business concerns. The stock exchange is an organised market where the ownership of existing shares can be transferred from one person or institution to another.

The important methods of the marketing of securities are the following:

(a) ***Issue to the Public*** **:** A public limited company may mobilise funds by selling securities directly to the public. A company which wanted to invite the public to subscribe to its issue of shares and debentures had, according to the Companies Act, to issue a prospectus. According to the Companies Amendment Act, 1988, prospectus is to be supplied on demand, instead of compulsion. However, an abridged prospectus should be furnished along with the application form.

A prospectus is a notice, circular, advertisement or any other document inviting offers from the public for subscription or the purchase of any shares or debentures of a body corporate. The prospectus, which aims at persuading the public to purchase the securities of the company, describes the prospects or advantages likely to accrue to the holders of the securities of the company and sets forth the particulars of the amount issued, the rights attached to the shares, the property purchased or agreed to be purchased by the company, details about directors, managing directors, the amount of minimum subscription to be received before allotment, the names and adresses of auditors, bankers, solicitors, etc.

The persons who intend to subscribe to or purchase the securities should apply in the manner specified within the specified date. On the basis of the application received, the subscribers will be allotted the specific number of shares or debentures, as the case may be. The allotment of securities is subject to compliance with such regulations as minimum subscription, receipt of minimum cash, payment of qualification shares, etc.

One advantage of the direct selling of securities is the relatively lower cost of raising capital because the brokerage, or commission, etc., payable to intermediaries is avoided. The direct placing of the securities is appropriate for companies with a good reputation. It may also be successful if the promoters themselves enjoy a very good reputation.

This method has, however, certain limitations. For a new company with promoters who are not popular and reputed, this method is not advisable because the public may be reluctant to take the risk of investing in such a venture. If the company fails to generate sufficient public response to the issue, its plans may flop. It has been argued that sufficient waiting time has to be given to enable the public to gather more information about the company before subscribing to the securities.

(b) Private Placement: The term *private placement* refers to the sale of an entire issue of securities by a company directly to one or a few investors, usually financial institutions. Here, the appeal to subscribe to or purchase the securities is made to the investors either directly or through brokers. This method is confined mostly to debentures. Insurance companies, investment companies, trust accounts, pension and provident funds, etc., are suitable institutions with whom the securities can be directly placed for subscription. The growth of institutional investors has increased the scope of private placing.

An important advantage of private placement is the absence of the risk of uncertainty in raising the capital. Moreover, the cost of raising the capital is very low because the commission and other charges are either nil or comparatively low, and no expenditure has to be incurred on issuing a prospectus.

(c) Offer to Special Classes: An established company may raise additional capital by any of the following methods :

(i) *Rights Issue* : The rights issue is an offer with a pre-emption right to the existing shareholders of the company to further contribute to its share capital. Under the rights issue, new shares are offered to the existing shareholders in certain proportion to their existing share ownership. However, the rights themselves are transferable and saleable in the market. Under the Companies Act, if a company increases its subscribed capital by the issue of new shares either after two years of its formation or after one year of the first issue of shares, whichever is earlier, these have to be first offered to existing shareholders with a right to reserve them in favour of a nominee. [1]

(ii) *Issue of Bonus Shares* : A company may capitalise its profits or free reserves by the issue of bonus shares to shareholders. Bonus shares are allotted to shareholders in proportion to their respective share holding. [2]

(iii) *Offer to the Employees* : The issue of shares may be offered to employees. This promotes better industrial relations and higher productivity.

(iv) *Offer to the Customers* : This is popular with public utilities. Share holdings by customers gives them some say in the affairs and functioning of the concern.

---

[1] Details of Rights Issue are given in the chapter on *Control of Capital Issues.*

[2] Details of the Bonus Issues are given under the *Control of Capital Issues.*

(v) *Offer to the Creditors* : At the time of reorganisation of the capital structure, creditors may be requested to purchase the shares in full settlement of their loans or advances.

It may be pointed out here that industrial finance corporations in India can exercise the option of converting loans into equity, subject to certain conditions.

(d) Underwriting: The marketing of securities with the support of, or by, underwriting is very popular because this method ensures that the subscription to or sale of the whole of the securities is underwritten.

UNDERWRITING OF SECURITIES

The marketing of securities is greatly facilitated by underwriting. An underwriting agreement is defined as "an agreement entered into before the shares are brought before the public that, in the event of the public not taking up the whole of them or the number mentioned in the agreement, the underwriter will, for an agreed commission, take an allotment of such part of the shares as the public has not applied for."

From the point of view of the issuing company, underwriting insures the risk of the public not taking up the required amount of securities. Needless to say, the facility of underwriting enables the company to raise the required capital; for if the public does not take up the whole of the issue, the balance left is taken up by the underwriter.

Methods of Underwriting

An underwriting agreement may take any of the following three forms:

(i) *Standing Behind the Issue* : Under this method, the underwriter guarantee the sale of a specified number of shares within a specified period. If the public does not take up the whole of the specified amount of the issue, the underwriters standing behind the issue come forward to puchase the balance.

(ii) *Outright Purchase* : Under this method, the underwriters purchase the issue outright and resell the securities to the investors. The purchase price may be negotiated between the issuer and the underwriter, or may be determinded by competitive bidding.

(iii) *The Consortium Method* : Under consortium method, also known as the syndicated method, as the name indicates, underwriting is jointly done by a group of underwriters who form a syndicate for this purpose. This method is usually adopted for large issues. The underwriting of large issues by a consortium enables the spread of the risk among the members of the syndicate—no single underwriter bears the entire risk.

Importance and Advantages of Underwriting

Industrial development is fostered, among other things, by the development of the securities market. A good securities market is one of the prerequisites for the growth of joint stock companies. The marketing of securities is necessary for raising the owned capital. Underwriting, therefore, assumes great significance.

A public company will have to secure the "minimum subscription" within 120 days after the issue of the prospectus without which the allotment of shares cannot be made; and without the declaration that it has received the stipulated minimum subscription, the company will not be able to obtain the certificate from the Registrar of Companies to commence business. Underwriters are of great help in ensuring that the company raises the rerquired share capital.

Underwriting, thus, plays a very important role in the development of the capital market and in fostering industrial development . It may be mentioned here that the growth of the underwriting business has been one of the important factors that have contributed to the development of the Indian capital market in the post-independence period. In the last one decade, the amount underwritten as a percentage of the total private capital issues offered to public varied between 72 per cent and 96 per cent. The underwriting business has grown phenomenally, thanks to public financial corporations, commercial banks and brokers. After the elimination of forward trading, brokers have been taking up underwriting risks in the new issues market.

The underwriting business offers the following advantages to the corporate sector:

(i) Underwriting relieves the issuer of the risk of not being able to find buyers for all the issues offered to the public. Thus, the company can be reasonably sure of raising adequate share capital.

(ii) Underwriters help the company to fulfil the statutory regulations, like securing the prescribed minimum subscription within the stipulated period.

(iii) Underwriters relieve the issuer of the burden of undertaking the highly specialised function of distributing securities.

(iv) Underwriters, having expert knowledge of the capital market conditions, can render expert advice to the company on the timing of security issues, the size and type of securities to be issued, the value at which they may be offered, etc.

(v) Underwriting business is of enormous assistance in the mobilisation of funds in the capital market becasue public confidence is enhanced by the underwriting of issues by reputed underwriters.

(vi) The activities of underwriters help stabilise capital market conditions.

UNDERWRITING IN INDIA

Professional underwriting service has developed in India from the mid-1950s. The Industrial Credit and Investment Corporation (ICICI), established in 1955, has played an important role in the developement of professional underwriting service. A number of factors were responsible for the relative underdevelopment of the underwriting business in the past. Underwriting grows along with the growth of the capital market and industrialisation, and it could not, thereforre, grow significantly because of the poor state of the industrialisation and capital market. The conservative attitude of the Indian commercial banks, the absence of specialised institutions like issue houses, investment institutions, financial syndicates as found in Western countries, the preponderance of the *managing agents* who played a multi-faceted role as promoters, financiers, underwriters, managers, etc., of the companies under their group, affected the development of the underwriting business in India.

Underwriting has, however, been developing in the country, particularly after the establishment of the ICICI in 1955. Public sector financial institutions, such as the IFCI, ICICI, IDBI, SFCs, UTI, LIC; commercial banks; investment companies and stock-brokers—all have played an important role in developing the underwriting service. After the elimination of forward trading, stock exchange brokers began to take on underwriting risks in the new issues. As stated earlier, statistics for the recent period show that the amout underwritten as a percentage of the total private capital issues offered to the public varied between 72 per cnet and 97 per cent.

Underwriting Agencies

The important underwriting agencies in India are :

(i) *Finance Corporations* : Public sector industrial finance corporations like the IFCI, IDBI, ICICI, etc., provide a sizeable underwriting support.

(ii) *Commercial Banks* : Of late, commercial banks have emerged from their conservative lethargy and have developed a more favourable attitude towards underwriting. Some banks have established merchant banking divisions. Though the underwriting business of commercial banks has grown significantly, their share in the total underwriting business is still very small.

(iii) *Investment Companies* : The investment companies, promoted mostly by large business houses, have played a very important role, especially in the early period, in the promotion of the underwriting business. Public sector institutions like UTI, LIC, and GIC do significant underwriting.

(iv) Stock-brokers : Some important firms of stock-brokers have also been doing considerable underwriting business. However, the firms of brokers have been doing the underwriting business as a subsidiary business.

INTERNAL FINANCING

(Ploughing Back of Profits)

An important source for fixed and working capital requirements of established companies is the savings generated internally in the form of retained earnings by the process of ploughing back of profits. A profitable company may retain with it a part of the net profits as undistributed profits to strengthen its financial position, or to meet some of the present or future financial requirements. The reserves thus built up over the years by ploughing back profits may be utilised for the following purposes :

(i) Expansion of the undertaking;

(ii) Replacement of obsolete assets and modernisation;

(iii) Meeting permanent (regular) or special working capital requirements;

(iv) Redemption of old debts.

Ploughing back of profits benefits the company, shareholders and society.

Benefits to the Company

The important advantages of retained profit from the point of view of the company are :

(i) It enables the company to withstand difficult situations—for example, a depression or recession, period of credit squeeze etc.

(ii) It enables the company to adopt a stable dividend policy. Sufficient retained earnings enable the company to pay the normal rate of dividend even if, in a particular year, the profit is very little, or the company incurs a loss.

(iii) Modernisation and expansion programmes will not suffer for want of finance if a company has large retained earnings.

(iv) Retained earnings can be made use of to set right any shorfalls in the provision for depreciation, bad and doubtful debts, and similar contingencies.

(v) The reserves built up out of undistributed profits may be made use of to retire bonds and debentures, to build up sinking funds, and to redeem debts.

(vi) Regular or permanent working capital requirements may be met by the surplus retained with the company.

(vii) It increases the creditworthiness of the company.

(viii) It may help increase the sales of the company because, as funds cause no problem, it can expand credit sales to a reasonable extent.

(ix) It reduces the dependence on external sources of finance.

Benefits to the Shareholders

Though the policy of ploughing back part of the profit limits the dividends, from the long-term point of view, it may benefit the shareholders. The main advantages from the point of view of the shareholders are :

(i) It provides a reasonable assurance to shareholders of a stable rate of dividend.

(ii) The soundness of the company and its stable dividends help appreciate share values.

(iii) Shareholders stand to benefit from the modernisation and expansion financed by retained earnings.

(iv) The redemption of debts may also benefit the shareholders.

Shareholders will further benefit from the better performance of the company because of its ability to withstand difficult situations and to carry out timely replacements and improvements.

Benefits to Society

Society, too, may, derive certain benefits if companies favour polughing back of profits.

(i) Modernisation and expansion financed by internal funds benefit society because they improve the supply position and may even reduce the cost of production, for expansion leads to economies of scale and modernisation increases productivity.

(ii) The increase in corporate investment increases employment opportunities.

(iii) Internal financing reduces the demand for funds in the capital market. It would, thus, increase the availability of funds for other investors.

(iv) Society benefits from the stability accorded to the industrial sector by the internal availability of funds.

Dangers of Polughing Back Profits

Some dangers are associated with indiscriminate policy of ploughing back profits. Some of the possible dangers are :

(i) It may lead to concentration of economic power because large retained earnings enable companies to enlarge their business easily by a continual reinvestment of the profits.

(ii) It gives scope for manipulation. The controlling powers of the company may depress share prices by keeping the dividend rate very low by ploughing back a substantial part of the profits that they might purchase the shares at low prices and later benefit from a higher dividend and appreciation of the share value due to the rise in the rate of dividends.

(iii) The top brass of the management may misuse the funds by locking them up in their pet concerns or companies under the same management against the overall interest of the shareholders.

(iv) It may lead to over-capitalisation if the reserves are capitalised by issuing bonus shares or bonus issues.

(v) The ploughing back of profits interferes with the rights and freedom of shareholders. If shareholders get higher dividends, they will be at liberty to distribute their investments as they like, whereas they, especially the small shareholders, do not have any significant say in the investment or utilisation of retained earnings.

(vi) From the above point of view, it follows that excessive ploughing back of profits may hinder the natural growth of the capital market.

Determinants of Retained Earnings

The following are the three important determinants of retained earnings:

(i) *Profits* : Obviously, the question of the ploughing back of profits does not arise if a company does not earn profits. Normally, a company has to declare a reasonable rate of dividend to satisfy the shareholders and to prevent a depreciation of share values. Hence, only what is left over after paying a reasonable dividend can be ploughed back. Thus, the amount of net profits is an important determinant of internal savings.

(ii) *Taxation* : The rate of corporate taxation is an important determinant of "net profts". A high rate of corporate tax imposes limitations on the building up of internal savings.

(iii) *Dividend Policy* : The dividend policy is an important determinant of retained profits. A conservative dividend policy is regarded as necessary to build up internal savings. Some people advocate a statutory ceiling on dividends to facilitate a greater ploughing back of profits. At times, the Government imposed ceilings on dividends.

PUBLIC DEPOSITS

Recent years have witnessed a significant increase in public deposits with companies (here the reference is to deposits with non-financial joint stock companies). Public deposits played an important role in industrial finance in the past as well. For instance, in the 1930s, it was an important source for the textile mills of Ahmedabad, Bombay, Sholapur, Bengal and the Punjab. The tea gardens of Bengal and Assam also depended on this source of finance.

The statistics released by the Government of Inida show that the total number of companies accepting deposits and the total amount of deposits have increased considerably.

Reasons for Popularity

The increasing popularity of public deposits has been mainly due to the following reasons :

(i) The rate of interest the companies have to pay on deposits from the public is lower than the interest on bank loans.

(ii) As the rate of interest offered by the companies have been significantly higher than the rates offered by banks for the same periods, there has been a good public response.

(iii) Public deposit has been an easier method of mobilising funds than from banks, especially during periods of credit squeeze.

(iv) To obtain credit from a commercial bank, the company has to satisfy the credit-worthiness of the purpose for which the loan is sought; but in the case of public deposits, there is no such need.

(v) It follows from this that public deposits may form a source to finance business activities for which bank finance is not available.

(vi) A further attractiveness of public deposits from the point of view of the companies is that they are unsecured.

(vii) Some public sector undertakings have also been drawing upon this source of finance.

Limitations

Public deposits, however, have certain demerits from the point of view of society.

(i) As public deposits are unsecured, depositors bear the risk of loss of money in the event of the failure of the company.

(ii) Public deposits with companies may cause a diversion of resources into non-priority and undesirable areas.

(iii) Public deposits tend to defeat the objectives of monetary policy, especially a dear money policy. They also distort the planned interest rate structure in the economy.

(iv) It has been argued by some people that public deposits adversely affect bank deposits. But this argument has been countered by pointing out that if public deposits activate the idle resources in the economy, they would help increase the deposits with commercial banks.

Regulation of Public Deposits

The Government has realised the need for the regulation of the acceptance of public deposits by companies in the interest of the depositing public, the efficacy of the monetary policy and resource utilisation. From time to time, the Reserve Bank has issued directives regulating public deposits.

The salient features of the regulation are :

(i) Deposits shall not exceed 25 per cent of the paid-up capital and free reserves.

(ii) The maximum period of deposits is 36 months.

(iii) Every company shall invest not less than 10 per cent of its deposit maturing during the year ending 31st March in a current or other account with a scheduled bank free from any charge or lien , or in approved securities. The amount deposited shall be used only for the repayment of deposits maturing during the year referred to under the rules.

(iv) Every company accepting deposits shall file periodical returns with the RBI, giving the required information about public deposits/ loans.

(v) While issuing advertisements and application forms soliciting deposits, the company should furnish certain specified information on its financial position and its working.

The Companies (Amendment) Act, 1988, has amended Section 58A of the Companies Act, 1956, and made the following provisions pertaining to public deposits :

(a) Every deposit accepted by a company after the commencement of this Amendment shall, unless renewed in accordance with the rules prescribed in this respect, be repaid in accordance with the terms and conditions of such deposit.

(b) Where a company has failed to repay any deposit or part thereof in accordance with the terms and conditions of the deposit, the Company Law Board (if it is satisfied, either on its own motion or on the applicaiton of the depositor) may direct, by order, the company to make the repayment forthwith or within such time and subject to such conditions as may be specified by the CLB.

(c) A company which fails to comply with such an order of the CLB shall be punishable with imprisonment which may extend to three years and shall also be liable to a fine of not less than Rs. 50 for every day during which such non-compliance continues.

25

Industrial Financial Institutions

Finance is a pre-requisite to mobilise real resources for organising production. In a developing economy, however, lack of finance is not the only deterrent to economic development. Even when finance is available, other important factors like imperfections in the information flow and dearth of entrepreneurship may come in the way of industrial and economic development. Hence, it is necessary to make finance and other development assistances in a package to take the dormant and developing economies to the take-off stage. The present trend, therefore, is to set up 'Development Banks' rather than institutions which merely provide finance.

"A Development Bank is a multipurpose institution which shares entrepreneurial risk, changes its approach in tune with the industrial climate and encourages new industrial projects to bring about speedier economic growth. The concept of development banking is based on the assumption that mere provision of finance will not help to bring about entrepreneurial development. Successful entrepreneurial banking should include the discovery of investment projects, undertaking the preparation of project reports, provision of technical advice and management services and finally assisting the management of industrial units."[1]

After Independence, starting with the establishment of the Industrial Finance Corporation of India in 1948, a number of development banks have been set up at all-India and State levels for assisting the development of large, medium and small industries by providing financial and various other promotional assistances.

There are three all-India Development Financial Institutions (DFIs), viz., Industrial Development Bank of India (IDBI), Industrial Finance Corporation of India (IFCI) and Industrial Credit and Investment Corporation of India (ICICI). The Industrial Reconstruction Corporation of India (IRCI) established in 1971 with the main objective of revival and rehabilitation of viable sick units was converted into the Industrial Reconstruction Bank of India (IRBI) in 1985 with more powers.

---

[1] K. V. Prabhakar, "Development Banks — New Trends", *Financial Express*, June 18 and 19, 1981.

Besides the four institutions referred to above, the all-India financial institutions (AIFIs) providing industrial finance are some investment institutions, namely the Unit Trust of India (UTI), Life Insurance Corporation of India (LIC), and the General Insurance Corporation of India (GIC) and its subsidiaries.*

Development banks have been established at the State level too. In 1987, there were 18 State Financial Corporations (SFCs) and 26 State Industrial Investment/Development Corporation (SIDCs).

Financial assistance is provided, directly or indirectly, also by National Small Industries Corporation (NSIC), State Small Industries Development Corporations (SSIDCs) and Khadi and Village Industries Commission (KVIC), although financing is only an ancillary function of these organisations.

The IDBI is the apex institution which co-ordinates the activities of various institutions.

A very important source of industrial finance is commercial banks.

Provision of rupee and foreign currency loans, subscription to shares and debentures, underwriting of shares and debentures, guaranteeing of deferred payments and loans are the important types of financial assistance provided by these institutions (some of the institutions do not provide some of these assistances).

Development activities of the DFIs include identifying industrial potentials of different areas; development of entrepreneurship through training and motivation; assistance in project identification, feasibility studies and preparation of project reports; technical and managerial consultancy; seed/risk capital assistance, etc.

Direct assistance from the all-India development banks is normally confined to projects costing over Rs.3 crores; various state level institutions and certain special institutions like the National Small Industries Corporation (NSIC), State Small Industries Development Corporations (SSIDCs), Khadi and Village Industries Commission (KVIC) and banks assist small-scale (including khadi and village) units and medium-scale units involving investment of less than Rs.3 crores. However, these institutions, particularly the IDBI, assist the small-scale sector indirectly, through schemes of refinancing, rediscounting of bills, resource support to institutions assisting small-scale sector, etc.

The limit of direct subscription by the all-India DFIs to equity of companies has recently been raised from Rs.50 lakhs to Rs.1 crore.

Projects involving very large investment are assisted by the all-India financial institutions through *consortium financing* (i.e., the project is jointly financed by a group of financial institutions). In consortium financing, one of the institutions plays the lead role. The AIFIs have been trying to make the single window concept more effective and to expedite the process of sanction and disbursement of assistance.

---

* These institutions are termed as investment institutions exclusively from the point of view of their industrial finance function.

The DFIs have sponsored a number of technical consultancy organisations (TCOs) and some institutes for entrepreneurial/management development.

The assistance sanctioned by all financial institutions (AFIs)* increased very substantially from Rs. 118.1 crores in 1964-65 to Rs. 54,212 crores in 1994-95.

The share of the AIFIs in the total sanctions is more than 90 per cent and of the state level development banks is one-tenth. IDBI, the premier institution, alone accounts for more than 27 per cent about of the total assistance by the AFIs.

About three-fourths of the cumulative assistance sanctioned by the AFIs have gone to the private sector, about 15 per cent has gone to the public sector, 77 per cent to the joint sector and the co-operative sector received 33 per cent.

INDUSTRIAL DEVELOPMENT BANK OF INDIA

The IDBI was established on July 1, 1964 under the Industrial Development Bank of India Act, 1964, as a wholly owned subsidiary of the Reserve Bank of India. In terms of the Public Financial Institutions Laws (Amendment) Act, 1975, the ownership of IDBI has been transferred to the Central Government with effect from February 16, 1976.

The most distinguishing feature of the IDBI** statute is that it has been assigned the role of the principal financial institutions for co-ordinating, in conformity with the national priorities, the activities of the institutions engaged in financing, promoting or developing industry. IDBI has been assigned a special role to play in the matter of:

(i) planning, promoting and developing industries to fill vital gaps in industrial structure;

---

* The expression All Financial Institutions (AFIs) refers to IDBI, IFCI, ICICI, LIC, UTI, GIC, IRBI, SFCs and SIDCs. The expression All-India Financial Institutions (AIFIs) refers to IDBI, IFCI, ICICI, LIC, UTI and GIC.

** Information for this chapter has been drawn mostly from the Annual Reports and information brouchures of financial institutions and Covernment publications.

(ii) providing technical and administrative assistance for promotion, management or expansion of industry; and

(iii) undertaking market and investment research and surveys as also techno-economic studies in connection with development of industry.

IDBI is also expected to co-ordinate, guide and monitor the entire range of credit facilities offered by the other institutions for the small and cottage sector.

IDBI is empowered to finance all types of industrial concerns engaged or to be engaged in the manufacture, processing or preservation of goos, or in mining, shipping, transport, hotel industry, generation or distribution oi power, fishing or providing shore facilities for fishing or in the maintenance, repairs, fishing or servicing of machinery or vehicles, vessels, etc. or for the setting up of industrial estates. The Bank can also assist industrial concerns engaged in the research and development of any process or product or in providing special or technical knowledge or other services for the promotion of industrial growth.

The IDBI Amendment Act, 1986, has enlarged the definition of industrial concerns eligible for assistance from IDBI to cover diverse range of industrial activities including the activities of services sector of industries like informatics, health care, storage and distributing of energy and other services contributing to value addition. The Act has also widened the scope of business of the Bank so as to cover consultancy, merchant banking and trusteeship activities. The range of financing instruments has been further enlarged to include lines of credit and letters of credit and IDBI has been permitted to grant loan and advances to individuals for investment in industrial concerns.

Further, the authorised capital of IDBI was raised to Rs. 1,000 crores and it can be raised further upto Rs. 2,000 crores by the Central Government by a notification in the official gazette.

As an apex development bank, the IDBI has been playing a leading role in the field of indstrial finance and promotion. Over the last two and a half decades, the bank has evolved new areas of promotional activities to meet the emerging needs for development of industry. It has also strengthened the institutional structure of industrial finance in the country with effective and appropriate linkages among the development financing institutions based on co-ordinated policies and practices. It provides resource support to State level institutions by way of refinance facilities and certain special schemes.

Although the direct financing by the IDBI is confined, by and large, to the medium and large-scale units, it has been assisting the small-scale sector through its contribution to several special schemes and resource support to the State level institutions.

The IDBI provides the following types of financial and promotional assistance:

(i) Term loans (both rupee and foreign currency).

(ii) Underwriting of and subscription to shares and debentures.

(iii) Financial guarantees for deferred credits and loans raised from other sources.

(iv) Soft loan assistance for modernisation.

(v) Under the Technical Development Fund Schemes, matching rupee resources by way of direct loans to industrial units which are recipients of import licences under T.D.F. Scheme of Government of India.

(vi) Under the Equipment Finance Scheme, loan assistance for import of capital goods or equipments by existing industries against IDBI credit or for imports covered by T.D.F. licences.

(vii) Under the Technical Assistance Fund Scheme:

  (a) Assistance for Entrepreneurship Development Programmes.

  (b) Assistance for self-employment of blind and handicapped.

  (c) Subsidy for turnkey arrangements entrusted to approved technical consultancy organisation (TCOs).

(viii) Seed capital assistance through SFCs and SIDCs to new entrepreneurs who do not have adequate source of their own for setting up industrial projects.

(ix) Refinance facilities to State level financial institutions and banks for providing assistance to small and medium industrial projects.

(x) 100 per cent refinance in respect of composite term loan upto Rs.25,000 sanctioned to artisans, village and cottage industries and SSI units in tiny sector and projects promoted by SC/ST and physically handicapped.

(xi) Special scheme of concessional refinance assistance to small-scale units covered under the credit guarantee scheme.

(xii) Refinance against loans upto Rs.2 lakhs granted to technician entrepreneurs by SFCs without insisting on promoter's contribution and at concessional rate of interest.

(xiii) Concessional finance for industries in the notified backward areas.

(xiv) Under the Textile Modernisation Fund Scheme, assistance for modernisation on concessional terms to spinning and composite textile and woollen mills.

(xv) Under the Venture Capital Fund Scheme, financial assistance for projects involving development and use of indigenous technology as well as for adaptation and use of imported technology.

(xvi) Under the Technology Upgradation Scheme, assistance for selected capital goods industries.

(xvii) Scheme for providing Automatic Stand by Credit for payment of enhanced customs duty on project imports.

IDBI provides financial assistance to cottage, tiny, small and medium entreprises through:

(i) refinance of industrial loans granted by SFCs, SIDCs, commercial/co-operative and regional rural banks;

(ii) rediscounting of bills arising out of sale of indigenous machinery;

(iii) seed capital assistance to new entrepreneurs;

(iv) resource support to SFCs, SSIDCs and NSIC by way of subscription to shares and bonds.

In order to step up the flow of assistance to the small sector and to provide a focal point to co-ordinate at the apex level the availability of both financial and non-financial inputs required for the orderly and healthy growth of this sector, the IDBI established in May 1986 Small Industries Development Fund (SIDF). In fulfilment of these objectives, the Bank took a variety of measures to increase the flow of assistance to this sector. Besides liberalising the terms of existing schemes, new schemes were introduced in favour of such special target groups as women entrepreneurs and ex-servicemen. Assistance is also made available for such purposes as financing in-house quality testing facilities, common quality testing centres, setting up of Training-cum-Development Centres in north-eastern states of the country, etc.

INDUSTRIAL FINANCE CORPORATION

The Industrial Finance Corporation of India was established in 1948 under the IFCI Act, with the object of making medium and long-term credit more readily available to industrial concerns in India. Today, IFCI's role extends to the entire industrial spectrum of the country. While it continues to be one of the important purveyors of direct financial assistance to eligible industrial concerns, no less important is its promotional role whereby it has been helping and developing the small and medium-scale industrial entrepreneurs by providing them much needed guidance through its specialised agencies in project identification, formulation and implementation, development of ancillary and small-scale industries, encouraging the adoption of indigenous technology, etc.

As in the case of the recent amendments to the IDBI Act, the amendment to the IFCI Act has broadened the scope of business of the Corporation and enlarged the list of industrial activities eligible for assistance by inclusion of infromatics, health care etc.

Direct financing is the Corporation's main business, the assistance under which can take any one or more of the following forms:

(i) Rupee loans;

(ii) Sub-loans in foreign currencies out of the foreign exchange lines of credit made available to it;

(iii) Underwriting of and/or direct subscription to the shares and debentures of public limited companies; and

(iv) Guaranteeing of -

  (a) Deferred payments for machinery imported from abroad or purchased within the country;

  (b) Foreign currency loans raised by industrial concerns from foreign institutions; and

  (c) Rupee loans raised by industrial concerns from scheduled banks or State Co-operative Banks or the market.

Like the other all-India development banks, IFCI also provides concessional finance to industrial units in notified backward areas.

IFCI has been designated as the nodal point to administer the Jute Modernisation Fund set up by the Government of India and which became operative from November, 1986, with a view to revitalising the jute industry and giving thrust to its modernisation programme.

Further, IFCI has been appointed as agent of the Government of India for making disbursement of loans from the Sugar Development Fund for rehabilitation and modernisation of sugar units and monitoring the end use of loans and affecting recoveries.

Being a development bank, the IFCI has been undertaking a number of development activities. These include the following.

(i) Guidance to new, tiny, small-scale and medium-scale entrepreneurs in project identification, formulation, implementation, operation etc.

(ii) Help to new and small entrepreneurs by subsidising the cost of Feasibility/Project Reports, market studies, diagnostic studies, revival of sick units, development of technology and in-house R&D efforts.

(iii) The Risk Capital Foundation (RCF) sponsored by the IFCI (established in 1976) provides risk capital assistance on soft terms to the first generation entrepreneurs to make good the shortfall in the requirement of promoters' contribution to the equity capital of the medium and medium-large industrial projects promoted by them in the cost-range of Rs.2 crores to Rs.15 crores. No interest is charged on the loans given by RCF, except a nominal service charge. The assistance is normally limited to 50 per cent of the promoter's contribution excluding the contribution from SIDC and/or other similar public sector financial institutions to the equity of a project.

During 1986-87, the Corporation introduced the Scheme of Interest Subsidy for Encouraging Quality Control Measures in Small-Scale Sector.

Recently, IFCI has set up a Merchant Banking Division (MBD) with its head office at Delhi and bureau in Bombay. The MBD undertakes assignments for capital restructuring, merger and amalgamation, loan syndication with other financial institutions, and trusteeship assignments. It guides entrepreneurs in project formulation and raising resources for meeting project costs.

INDUSTRIAL CREDIT AND INVESTMENT CORPORATION OF INDIA

The Industrial credit and Investment Corporation of India Limited (ICICI) was set up in 1955 to encourage and assist industrial development in India.

Its objectives, inter alia, include:

(i) providing assistance in the creation, expansion and modernisation of industrial enterprises;

(ii) encouraging and promoting the participation of private capital, both internal and external in such enterprises; and

(iii) encouraging and promoting industrial investment and the expansion of investment markets.

In pursuit of its objective of promoting industrial development, ICICI provides financial assistance in various forms such as—

(a) Underwriting of public and private issues and offers of sale of industrial securities—ordinary shares, preference shares, bonds and debenture stock;

(b) Direct subscription to such securities;

(c) Securing loans in rupees, repayable over periods up to 15 years;

(d) Providing similar loans in foreign currencies for payment for imported capital equipment and technical services;

(e) Guaranteeing payments for credits made by others;

(f) Providing credit facilities to manufacturers for promoting sale of industrial equipment on deferred payment terms.

ICICI sells securities from its own portfolio to investors whenever it can get a reasonable price for them. It does so for the dual purpose of revolving its resources for new investments and for encouraging the investment habit in others, thereby promoting widespread distribution of private industrial securities. Thus, unlike the normal investor, ICICI does not retain successful investments merely because they are profitable. On the contrary, dissemination of profitable investments is in accord with its broad objectives and the form of ICICI's own investment in a particular enterprise is often influenced by the prospect of selling it eventually.

The primary purpose for which assistance is extended is purchase of capital assets in the form of land, buildings and machinery. Of the alternative types of assistance provided by ICICI, the one best calculated to assure the success of enterprises is chosen in each case.

A significant feature of ICICI's operations is the relatively high share of foreign currency loans in its assistance portfolio compared to other all-India development banks.

Towards the national objective of development of backward regions, ICICI has been extending financial assistance on concessional terms to new projects located in backward areas.

ICICI played an active role in the techno-economic surveys of various States under the initiative of the all-India financial institutions. The surveys were carried out to determine the industrial potential of the selected States and to suggest measures for realising such potential. The effort was to identify specific projects based on local resources, which would be of maximum benefit to the economy.

ICICI, in consortium with IDBI and IFCI, operates the Soft Loan Scheme for modernisation of industrial concerns in cement, sugar, cotton textiles, jute and certain engineering industries.

Consistent with its corporate philosophy and its role as an experienced development bank, ICICI provides promotional assistance to worthwhile projects. The Corporation has provided, on a formal basis since 1973, promotional assistance like identification of new projects on the one hand and location of suitable entrepreneurs on the other. In selecting projects for this purpose, preference is given to those with a potential to cover immediate and emergent gaps in the economy. Special consideration is also given to new products and processes. It provides comprehensive guidance to entrepreneurs on selected projects for their formulation on sound lines and expeditious maturing to a bankable stage. In suitable cases a small fee is charged for these services. The regional offices of the Corporation also contribute to these activities and serve as convenient contact points for entrepreneurs.

ICICI started a Merchant Banking Division in 1973 for advising clients, on a selective basis, on raising finances in suitable forms and on restructuring of finances in existing companies. It also advises clients on amalgamation proposals. Assistance is provided in preparing proposals for submission to financial institutions and banks for negotiations with them for loans and underwriting. The Division acts as Managers to the Issue of Capital. Assistance is provided for completion of formalities connected with the public issue and of legal formalities for raising loans. ICICI charges a suitable fee for these services.

The Corporation has taken some initiatives in the field of rural development since 1976. It has assisted, on an experimental basis, projects of landscaping, agricultural research and lift irrigation.

The Corporation's interest and initiative in rural development activity was enlarged during 1977 and Rs.25 lakhs were earmarked for projects of rural development to be taken up in association with industrial units and voluntary social service organisations.

ICICI considers financial assistance on liberal terms to suitable rural development schemes initiated either by voluntary organisations or corporate bodies. The scheme should have a demonstration value and be replicable in other rural areas. They should aim at improving living conditions of the rural population and their impact should be measurable. For bankable rural development schemes, ICICI extends financial assistance in the form of seed money/margin money or suitable interest rate subsidy. For other deserving but non-bankable schemes, ICICI extends financial support depending on their merit and requirements.

ICICI has been instrumental in setting up the Institute for Financial Management and Research at Madras. The Institute has been conducting specialised courses and carrying on research in the field of financial management.

An important development initiative taken by ICICI resulted in the formation of Housing Development Finance Corporation Limited (HDFC) in 1977. HDFC provides long-term loans on reasonable terms, primarily for lower and middle income group housing.

The ICICI which commenced leasing operations in 1983, provides leasing assistance for computerisation, modernisation/replacement schemes, equipment for energy conservation, export orientation, pollution control, balancing and expansion. The industries assisted under leasing include textiles, engineering, chemicals, fertilizers, cement, sugar etc. ICICI has made significant efforts in promoting investments in information technology, service industry like hotels and agro-based sectors like hatchery and poultry.

In 1987, ICICI launched its Venture Capital Scheme under which long-term financial assistance is extended to projects involving development and/ or commercialisation of new technologies, for which entrepreneurs, due to inherent high risks, may not be able to raise funds through conventional lending mechanisms. The assistance is provided in the form of participation in share capital, conditional loans and normal loans.

The Corporation is administering and managing the Programme for the Advancement of Commercial Technology (PACT) which commenced with a grant of US $ 10 million from the United States Agency for International Development (USAID). The primary emphasis of PACT is on market oriented R & D activity from which India and USA would derive economic benefit.

ICICI provides special assistance to technology development projects based on indigenous R&D efforts.

In order to broad-base technology development oriented activities, the Corporation has promoted a new company called Technology Development and Information Company of India Ltd. (TDICI) The major functions of TDICI would be technology financing and technology information. Technology financing will include financing of commercial R&D schemes through grants and conditional loans, venture capital financing and technology upgradation financing.

The Credit Rating Services of India Limited (CRISIL) promoted by ICICI became operational in 1987. CRISIL, in whose equity banks and financial institutions have participated, is an independent organisation managed professionally.

INDUSTRIAL RECONSTRUCTION BANK OF INDIA

In 1971, the Government of India established an institution, namely, Industrial Reconstruction Corporation of India (IRCI), with the main objective of reconstruction and rehabilitation of industrial units which were closed down or were facing the risk of closure but which could be made viable with suitable assistance.

The need for a more powerful institution to deal with the problem of industrial sickness was felt and on March 20, 1985, the Industrial Reconstruction Bank of India (IRBI) was established as per the provisions of the Industrial Reconstruction Bank of India Act, 1984, and the erstwhile Industrial Reconstruction Corporation of India was vested and transferred to the IRBI on that date

The IRBI functions as the principal all-India credit and reconstruction agency for industrial revival, assisting and promoting industrial development and rehabilitating industrial concerns. It has also to co-ordinate similar work of other institutions engaged in this field.

The IRBI gives loans for modernisation, diversification, expansion and renovation as also for meeting supplementary needs such as bridging liquidity gap and for working capital requirements. The other forms of assistance include lines of credit, equipment leasing, hire purchase, etc. The Bank extends assistance to sick small-scale units under its line of credit scheme which is operated through various State level agencies.

To arrest sickness at its incipient stage or to prevent any unit from falling to sickness, the IRBI has been emphasizing the need to obtain economic size of operation, modernisation, diversification, technological upgradation etc. of its assisted units, either singly or jointly in consortium with other all-India financial institutions. The IRBI also provides consultancy services to banks and financial institutions on a selective basis and merchant banking services for amalgamation/merger and reconstruction.

STOCK HOLDING CORPORATION OF INDIA

A new company, namely, the Stock Holding Corporation of India Ltd. (SHCI), was recently established with its registered office in Bombay, in order to secure efficient post-trade processing services for transactions in securities carried out by the all-India financial and investment institutions (IDBI, IFCI, ICICI, IRBI, LIC, UTI and GIC). SHCI is owned at the outset by the seven sponsoring institutions. It would hold custody of securities of the sponsoring institutions and handle transfer of securities as also collection of dividend/interest in respect of such securities on their behalf. After setting up the infrastructural facilities and gaining experience in the field, SHCI would extend its services to others such as stock-brokers and individual investors when it would make a public issue of share capital.

DISCOUNT AND FINANCE HOUSE OF INDIA

The Reserve Bank of India, together with public sector banks and financial institutions, has recently set up a company called the Discount and Finance House of India Limited (DFHI), to deal in short-term assets in order to provide liquidity in the money market.

STATE FINANCIAL CORPORATIONS

The State Financial Corporations Act, 1951, has enabled the State Governments to set up State Financial Corporations (SFCs) to function as regional development banks, making a significant contribution to the industrial advancement of their respective States.

The SFCs are meant to finance small and medium-scale industries.

Apart from their share capital, the SFCs depend for financial resources on repayment of loans and income from investments, issue of bonds, refinancing of loans from the IDBI and to a limited extent on borrowings from the RBI, deposits from the public and occasionally loans from the State Governments.

The SFCs do not normally lend more than Rs.60 lakhs to a single concern. The prohibition is intended to ensure that the SFCs do not deviate from the main objective of their creation, namely, catering to the requirements of the small and medium-scale sectors. The large concerns can approach the all-India financial institutions — IFC, IDBI and ICICI.

Loans or advances are granted primarily for the establishment of new industries or for expansion and development of existing industrial concerns. Loans to the new industrial concerns will be considered where a feasible scheme has been prepared and the initial capital has been collected by the prospective industrial unit. In case of existing industrial concerns loans are granted for the purpose of expansion or renovation of units. In both the cases, loans are granted for the purpose of acquiring tangible assets in the form of land, building, plant and machinery and other accessories. Foreign currency loans are granted for importing plant and machinery, other accessories and machine tools and technical know-how in special cases. With the exception of shipping, SFCs are now empowered to assist all industrial activities including mining, transport by ropeways and development of industrial areas.

Types of Assistance

Financial assistance from State Financial Corporations takes the following forms:

(i) Granting of loans or advances and subscribing to the debentures of industrial concerns, repayable within a period of not exceeding twenty years.

(ii) Guaranteeing loans raised by industrial concerns in the capital market or from scheduled banks or state co-operative banks.

(iii) Guaranteeing deferred payments due from any industrial concern in connection with its purchase of capital goods within India.

(iv) Underwriting the issues of stocks, shares, bonds or debentures by industrial concerns.

(v) Subscribing to the stocks, bonds or debentures of an industrial concern out of the funds representing the special class of share capital subscribed by the State Government and the IDBI in accordance with the provisions of Section 4A of the SFCs Act, 1951.

The main activity of the SFCs is providing loans and some of them also underwrite shares of industrial concerns. The SFCs grant loans mainly for the acquisition of fixed assets like land, buildings and plant and machinery. Sometimes, they also provide loans for working capital margin in combination with loans for acquisition of fixed assets.

SFCs are also providing foreign currency loans to small and medium-scale industrial units for import of plant and machinery and/or technical know-how under the IDA — World Bank credits to IDBI.

STATE INDUSTRIAL DEVELOPMENT/INVESTMENT CORPORATIONS

Since 1960, many States and Union Territories have set up State Industrial Development Corporations (SIDCs)/State Industrial Investment Corporations (SIICs), with the main object of accelerating the industrial development of the respective States and Union Territories.

The SIDCs/SIICs have been promoted by the State and Union Territories as promotional bodies entrusted with the major task of promoting industries and ensuring balanced regional growth within each State.

For efficiently carrying out the functions of promotion, improvement and development of industries, these Corporations are empowered to plan, formulate and execute industrial undertaking, project or enterprise which is likely to accelerate industrial development. Further, they promote medium/large industrial ventures as joint sector units in collaboration with private entrepreneurs, or as wholly owned subsidiaries and provide risk capital to new generation entrepreneurs. Various incentive schemes of Central/State Governments are also administered through them.

These Corporations undertake a wide range of functions. The important functions are:

(1) Grant of financial assistance to industrial concerns in the form of:
   (a) direct investment,
   (b) loans,
   (c) extension of guarantee for loans and deferred payments, and
   (d) underwriting and subscriptions to the issue of shares, bonds and debentures;

(2) Promotion and management of industrial concerns;

(3) Provision of industrial sheds/plots; and

(4) Promotional activities such as identification of project ideas, selection and training of entrepreneurs, provision of technical assistance during project implementation, etc.

The Corporations in States like Karnataka and Bihar are empowered to undertake special activities like establishing and managing industrial estates, development of industrial areas, generation, transmission and sale of electricity etc.

Out of the 26 Corporations in operation in the country in 1986-87, nine were also functioning as SFCs.

INVESTMENT INSTITUTIONS

Unit Trust of India

The Unit Trust of India (UTI), a public sector investment institution, was established in 1964, under the Unit Trust of India Act, 1963.

The share capital of the UTI was subscribed by the IDBI, LIC, SBI and its subsidiaries and other scheduled banks and financial institutions. Sale of units and other savings schemes are the main sources of funds for the Trust.

The main objective of the UTI is to mobilise the savings of the community and channelise them into productive corporate investments so as to provide for growth and diversification of the economy. It is at the same time intended to provide the facility for an equity type of investment to the large and growing number of investors in the small and medium income groups.

The UTI mobilises funds from the public through a number of schemes. The savings thus mobilised is channeled into productive activities by the Trust by investing them in the shares and debenture of industrial concerns.

It is one of the main intentions of the UTI to provide opportunity to investors belonging to small and medium income groups to indirectly participate in the ownership of shares and debentures of joint stock companies.

For small investors, the UTI offers the advantages of (i) considerably reduced risk since funds are invested in a balanced and well distribute portfolio; (ii) the benefit of expert management; (iii) a steady income; and (iv) liquidity.

The Trust's investment in any one company is restricted to certain specified limits in the interests of diversification. Its investment is expected to cover a judiciously selected diverse portfolio of securities designed to give to the Unit holders security of capital, besides reasonable return and capital appreciation.

Underwriting the public issues of shares and debentures, direct subscription to the shares and debentures and subscription to the privately placed debentures are the usual forms of assistance provided by the UTI to the industries.

The UTI examines the proposals for underwritings from the point of view of financial viability of projects, prospective earnings from investments to the Trust and prospects of capital appreciation. Consistent with these considerations, the Trust underwrites public issues of equity shares, preference shares and debentures.

The Trust has also joined the Inter-Institutional Meeting Forum of all India financial institutions, viz., IDBI, IFCI, ICICI, LIC and GIC under the aegis of the IDBI and the UTI indicates its intention to provide financial assistance to the projects in these meetings. For such assistance. the Trust follows more or less the norms prescribed by the IDBI.

Particularly in recent years, there has been a very substantial increase in the investible funds of the Trust. Several skillfully designed new savings schemes which have enabled the tapping of the savings potentials of various segments have significantly contributed to this growth.

Apart from registering appreciable growth in sales, number of unit holding accounts, investible resources, income and reserves, the UTI has also been one of the significant participants in the share capital of new financial organisations such as Infrastructure Leasing and Financial Services Ltd., Discount and Finance House of India Ltd., Credit Rating Information Services of India Ltd. Stock Holding Corporation of India Ltd. and Can Fin Homes Ltd., which are expected to play a vital role in the improvement and development of the money and capital markets and housing finance in India.

Life Insurance Corporation of India

Consequent to the decision to nationalise the life insurance business, the Life Insurance Corporation of India was established in 1956 as a wholly owned corporation of government of India in order to carry on the business of life insurance and deploy the savings to the best advantage of the policy holders and the community as a whole.

A large part of the funds of LIC is deployed as loans to assist the development of social overheads like housing, rural electrification, water supply and sewerage schemes.

However, LIC provides substantial assistance to the industrial sector. Besides normal investment operations by way of sale and purchase of securities in stock markets and investment in government securities, the Corporation has been participating with other all-India institutions in extending direct assistance to industries in the form of loan and direct subscription to shares and debentures of industrial concerns. LIC extends resource support to the term lending institutions by way of subscription to their bonds and thus contributes to industrial financing in an indirect manner. The Corporation also helps small and medium industries by granting loans for setting up of industrial estates.

General Insurance Corporation of India

As a member of the consortium of all-India Financial Institutions, the General Insurance Corporation of India and its four subsidiaries (The United India Insurance Co. Ltd., Oriental Fire and General Insurance Co. Ltd., National Insurance Co. Ltd., and New India Assurance Co. Ltd.) provide assistance to industries in the form of loans, underwriting and direct subscriptions to shares and debentures, placement of short-term deposits with companies, etc.

Besides taking right entitlement and underwriting of debenture issues, GIC, alongwith LIC and UTI. buys back debentures tendered by individual holders back to companies for encashment after a stipulated period and thus provides liquidity to such long-term financial assets.

It may be noted. that, as per Government guidelines, investment towards socially-oriented purposes (mainly in the form of Central/State Government securities, bonds of public sector undertakings, etc.) should constitute around 70 per cent of annual investible funds of GIC.

INSTITUTIONS FOR SMALL INDUSTRY

NSIC

The National Small Industries Corporation Ltd., which is wholly owned by the Government of India and meant exclusively for the development of small-scale industries, was established in 1956. The NSCI with its head office at Delhi has regional/suboffices in several places.

The main functions of the Corporation are the following:

(i) Supply of machinery, both indigenous and imported, on hire purchase to help setting up of new small ancillary units and to modernise existing ones.

(ii) The Corporation's Prototype Development and Training Centres at Okhla, Howrah, Rajkot and Madras and the subcentres at Kashipur, Aligarh and Dindigril and the demonstration-cum-training centre at Guwahati develop proto-types which may be transferred along with know-how to manufacturing units for commercial production, and/or renders training in various engineering trades.

(iii) Under the Raw Materials Assistance Scheme, small-scale units are supplied raw materials — imported and scarce indigenous ones — on a continuing basis, giving them also the benefit of bulk purchases.

(iv) NSIC helps the marketing of products of small-scale units under the Government Stores Purchase Programme as well as under its Internal Marketing Programme through consortia approach. In the field of export marketing, the Corporation has adopted a 'Single Window' assistance programme.

Further, with a view to creating facilities for regular display of products of the small-scale sector. NSIC has recently set up show rooms-cum-marketing development centres in Madras, Delhi and Calcutta and plans to have such centres in other principal towns of the country.

(v) NSIC undertakes small industries projects on turn-key basis and provides total services from feasibility studies to installation and commissioning of plant.

SSIDCs

State Small Industries Development Corporations have been set up to serve the needs of small-scale industries in the respective States/Union Territories. All the SSIDCs have been incorporated under the Companies Act so as to lend them the desired operational flexibility to undertake a variety of activities for the benefit of small-scale industries.

The specific activities undertaken by the SSIDCs include:

(i) procurement and distribution of raw materials;

(ii) supply of machinery to small entrepreneurs on hire purchase basis;
(iii) management assistance to production units;
(iv) operation of seed capital scheme on behalf of the State governments;
(v) construction and management of industrial estates;
(vi) participating with other institutions in setting up of technical consultancy organizations, and
(vii) undertaking marketing activities.

In addition to the above, SSIDCs have been providing infrastructural facilities like sheds, godowns and common production facilities, technical and consultancy services, particularly to the unemployed, like preparation of feasibility reports, formulation of project reports and planning for modernisation/diversification of existing product range and implementation of projects. Some SSIDCs have also sponsored industrial potential surveys in some districts to identify viable small-scale projects to be based mainly on locally available raw materials and local demand conditions.

SSIDCs also arrange for marketing of finished products of small industrial units both in domestic as well as international markets under their Marketing Assistance Scheme.

Many SSIDCs are actively associated with the setting up of emporia to assist small-scale units in marketing their products. Such emporia have been set up in metropolitan cities and also places of tourist importance. The showrooms established are consumer goods oriented and are aimed at ensuring reasonable prices to both the producers and the consumers. Further, SSIDCs also organise and participate in exhibitions in various markets. The products involved are mainly handicrafts, handlooms, ready-made garments, sports goods and the like.

KVIC

The Khadi and Village Industries Commission, established as a statutory organisation under the Khadi and Village Industries Commission Act, 1956, provides various schemes of assistance which cover extension of finance right from the stage of procurement of raw materials, tools and implements to the production of goods and their marketing.

For more information about KVIC, see the chapter on Khadi, Village and Small Industries.

SIDBI

Setting up of Small Industries Development Bank of India (SIDBI) marked the fulfilment of a long felt need to have a separate institution at the national level to exclusively cater to the requirements of the small scale sector in the country. SIDBI became operational on April 2, 1990 with an initial paid-up capital of Rs. 250 crore and taking over the outstanding portfolio of IDBI relating to small scale sector held under the Small

Industries Development Fund (SIDF) as of March 31, 1990 amounting to Rs. 4,200 crore. The authorised capital and paid-up capital of the Bank were subsequently raised to Rs. 500 crore and Rs. 450 crore respectively.

SIDBI, a wholly owned subsidiary of the IDBI, is designed to function as the principal financial institution for promotion, financing and development of industry in the small scale sector and to co-ordinate the functions of institutions engaged in similar activities. The role envisaged is wide ranging. SIDBI's Statute allows considerable flexibility and empowers it to assist the entire spectrum of small, tiny, village and cottage industries in the decentralised sector. The range of assistance comprises promotional, financing and extension support, which will be made available through appropriate schemes to cover setting up of new projects and expansion, diversification, modernisation and rehabilitation of existing units.

As principal institution for development of small scale sector, SIDBI would make full use of the existing credit delivery structure and support service agencies and strengthen their capabilities so as to reach out their services to the smallest of the small scale units situated in the remotest parts of the country. SSI units which number more than 18.3 lakh have a wide geographical spread-out in the country. The network of branches and field offices of banks and State-level institutions are ideally located for serving the small sector units. These factors have been kept in view while envisaging the role of SIDBI as the principal financial institution as provided in its Statute. SIDBI will, however, step in for directly assisting the activities which are essential for the healthy growth of small scale units but not covered by the existing agencies. Thus, the approach of SIDBI will be to supplement the efforts of existing institutions, strengthening their capabilities through financial and other forms of support and instituting suitable co-ordination mechanism. SIDBI's assistance by way of refinancing is channelised through SFCs, State Industrial Development Corporations (SIDCs), commercial banks, co-operative banks and RRBs. It provides rediscounting facilities to commercial banks apart from resource support to SSIDCs and NSIC for extending raw material and marketing support and leasing and hire-purchase facilities to SSI units.

The activities of SIDBI have been patterned to suit the requirements of small scale industries consisting of both modern and traditional ones. Broadly, these activities can be categorised as under:

(i) refinancing of term loans granted by banks and other eligible financial institutions;

(ii) direct discounting as well as rediscounting of bills arising out of sale of machinery/capital equipment by manufacturers in small scale sector on deferred credit;

(iii) equity type assistance under National Equity Fund (NEF) and by way of seed capital to entrepreneurs;

(iv) rediscounting of short term trade bills arising out of sale of products of small scale sector;

(v) resource support to NSIC and other institutions engaged in supply of raw materials, marketing of SSI products, setting up of industrial estates, development of industrial areas and infrastructure, extension of hire-purchase and leasing facilities;

(vi) direct assistance for setting up and expansion of marketing outlets for SSI products and development of industrial areas for SSI units;

(vii) share capital and resource support to factoring organisations;

(viii) assitance for promotion of exports of SSI products; and

(ix) extension of technical and other related support services for promotion, development and growth of small scale sector.

In consonance with the objectives envisaged in the Statute, SIDBI has evolved new schemes of assistance while at the same time continuing the schemes of assistance hitherto operated by IDBI for the small scale sector under SIDF. SIDBI has also given special attention to liberalisation and simplification of existing schemes of assistance, simultaneously with extension and support services like modernisation and technology upgradation. Details of the extension and support services being rendered by SIDBI are given in Chapter 5.

COMMERCIAL BANKS

Commercial Banks are a very important source of finance for the industry. The industrial sector is getting around 50 per cent of the total banks credit.

Particularly since the major bank nationalisation of 1969, there has been a substantial expansion of the bank branch net work and a substantial growth of the bank deposits and credits.

Commercial banks in India had been following the orthodox British line of disfavouring term loans to industries. However, there has been a change in their attitude.

In respect of term finance, the commercial banks, besides providing term credit and subscribing to shares and debentures, indirectly participate in term finance by subscribing to the shares and debentures of financial institutions. Commercial banks also do underwriting of shares and debentures. Some of the banks have merchant banking divisions. Scheduled banks have been permitted to hold in their own investment portfolio shares and debentures of the private corporate sector devolving on them through their underwriting and merchant banking commitments. However, according to RBI directives, such investments should be normally limited to the extent of 1.5 per cent of the incremental deposits of the previous financial year.

Further, in order to ensure proper co-ordination between commercial banks and State level financial institutions, banks were advised to take certain measures which, *inter alia*, include joint or simultaneous project appraisal, in principle commitment by banks at an early stage to provide working capital finance and sanction of working capital limits by banks at least three months before the units are due to commerce production.

The shift in favour of the 'priority sectors' led to a decline in the share of the industrial sector in the total bank credit. Today the industrial sector accounts for about half of the total bank credit compared to over-two-thirds prior to the nationalisation of 1969. This decline in the share has been confined to the medium and large sectors. Small industry is a priority sector and there has been a very significant increase in the proportion of the credit flow to this sector. In the two decades between March 1968 and March 1987, the share of the small-scale industries in the total bank credit more than doubled (from 6.9 per cent to 14.6 per cent). On the other hand, the share of the medium and large industries declined from 60.6 per cent to 35.5 per cent during this period.

APPENDIX 25.1

LEASING

Basically, leasing is an arrangement between the leasing company or the lessor and the user or the lessee, the former arranging to buy the capital equipment for the use of the latter. The lessee has to pay the lessor in the form of rentals and the lessor remains owner of the equipment during the specified period.

There are four types of leases, viz., (i) operating lease, (ii) financial lease, (iii) sale and lease back transaction, and (iv) the leveraged lease.

Operating lease refers to a short-term lease of an asset for an hour, a day, etc.

The financial lease is for a basic term during which the lease is non-cancellable. The length of this basic period is determined primarily by the economic life of the asset, and is usually shorter than the expected life. This arrangement provides some means by which the company may continue to use the asset after the expiry of the basic lease period, or alternatively a market purchase price is negotiated on the lease termination.

The sale and lease back transaction provides for an arrangement by which an entity that owns a given asset may sell it to the leasing company, and lease it back. This enables the lessee to immediately defreeze the money that it has locked into the original asset, which becomes available to it for working capital or further expansion.

In case of very large assets, a single lessor may not be capable of acquiring it or may not be willing to shoulder the whole risk associated with. Hence, two or more lessors may jointly acquire the asset and lease it to the lessee. Such an arrangement is known as leveraged lease. The leveraged lease is, thus, similar to consortium financing.[1]

Leasing companies claim the following principal advantages for the lessee.[2]

---

1. For more details, see Farouk Irani, "Leasing Companies and Banks," *Commerce*, May 28, 1983.

2. These are mentioned in the feature on Leasing Industry brought out by the *Commerce*, May 28, 1983.

(i) Leasing conserves cash flow by providing hundred per cent finance and enables the companies to employ their funds for working capital requirements.

(ii) Lease obligations are not reported as company's liabilities, whereas loan obligations must be recorded. Consequently, by financing the asset acquisitions with lease, rather than borrowing, a company can report a better debt-equity ratio.

(iii) Leasing facilities provide certainty and cash flow forecasts as well as budget controls can be more accurate.

(iv) Leasing, although a firm commitment, is a revenue expense and lease rental is an allowable expenditure under the Income-tax Act.

(v) Leasing also offers additional cost recovery for such constracts which allow recovery of rent, but not interest costs.

(vi) Formalities to be gone through for obtaining the lease financing are much less than bank or institutional financing arrangements.

(vii) Leasing facilities are more flexible. Adjustments to rentals schedule can be made to accommodate the special needs of leases.

Leasing as a financial alternative to equity capital or bank term finance was introduced to the modern world by the United States of America where it became effective during the 1940s and 1950s. In some of the industrially advanced countries, leasing today plays a very important role in the acquisition of capital goods. It is estimated that in the USA, leasing industry finances about 25 per cent of capital goods acquisition and in the United Kingdom it accounts for about 15 per cent. The leasing industry has taken great strides in the United States. In 1973, it was estimated that the volume of lease assets in the U.S. touched $ 60 billion with an annual accretion rate that was estimated at a level exceeding $10 billion. The estimates made in 1982 have suggested that the annual accretion to lease assets in the United States is approximately $30 billion, with the leasing industry financing almost 25 per cent of all capital goods acquisition.

In India, the leasing industry took roots with the establishment of the First Leasing Company of India Ltd., in Madras, which started functioning in 1973-74. "The Indian leasing industry grew disjointedly with the First Leasing Company of India Limited operating alone for almost seven years, followed thereafter by several other companies in the late seventies after which a mini entreprenurial revolution took place."[3] Several public sector institutions like the ICICI, IFCI, State Bank of India, Canara Bank, some SIDCs, etc. have also entered the leasing business, either directly or indirectly.

---

[3] **Farouk Irani, "Bright Days Ahead"**, *The Economic Times*, April 28, 1986.

26

Labour Legislation

The protection of the interests of labour was long held as one of the important responsibilities of the state. However, some recent developments indicate that the Government should intervene to prevent the legitimate rights of consumers, the general public, and employers from being denied by the militant might of organised labour. But many a time there is a tendency to ignore the latter aspect.

The Constitution of India directs the state to provide work to every citizen who is willing and able to work. Article 42 requires the state to make provision for securing just and humane conditions of work and for maternity relief. Article 43, which is described as the *Magna Carta* of the Indian worker, imposes upon the state theobligation, *inter alia*, to secure, by suitable legislation or economic organisation or in any other way, to all workers, agricultural, industrial or otherwise, work, a living wage, conditions of work ensuring a decent standard of life, full enjoyment of leisure, and social and cultural opportunities.

Labour legislation is regarded as " a most dynamic institution. From a simple restraint on child labour in 1881, labour legislation in India has become an important agency of the State for the regulation of working and living conditions of workers, as indicated by the rising number and variety of labour Acts. This rapid development of labour legislation is an integral part of the modern social organisation."[1] "Like slave labour in ancient times, serf labour in medieval times and indentured labour in transitional periods, the relics of all of which are still to be found in many backward contries, free labour is the direct result of growing industrialism and democracy, and labour legislation is the institution through which the State protects the interest, ameliorates the moral and material conditions, of the working classes."[2]

---

1. S. C. Kuchhal, *The Industrial Economy of India*, *op. cit.*, p.445.
2. R. K. Das, *Principles and Problems of Indian Labour Leg*[illegible] S. C. Kuchhal, *Ibid.*, p.445).

Principles of Labour Legislation

(i) *Social Justice:* The principle of social justice demands that the State should afford protection to workers against harmful effects to their health, safety and morality, of their working conditions, as well as ensure a reasonable wage. But what is not sufficiently recognised and emphasised is that organised workers shall not be allowed to exercise their might to meet socially unjustifiable rights and hold public life at ransom.

(ii) *Social Equity:* The principle of social equity demands that the changes in the socio-economic and political conditions and environment should be appropriately absorbed into labour legislation from time to time.

(iii) *International Uniformity:* The International Labour Organisation (ILO) has been playing a very important role in ensuring uniformity in the labour legislation of different countries. The ILO helps in providing a common platform for men engaged in the filed or industrial relations to study and understand the norms of social justice and social equity, applied to labour matters in diffent countries, and adapt them intelligently in their respective countries, with due regard for their own national economy. Most labour legislation in India is based on this principle.

(iv) *National Economy:* While formulating labour laws in respect of wages, working conditions, welfare, social security, etc., it is very important to bear in mind the general economic situation of the country.

Classification of Labour Legislation

V. V. Giri classified[3] the labour legislation in India under the following broad heads:

I. Laws Relating to Weaker Sections

(i) Children
(ii) Women

II. Laws Relating to Specific Industries

(i) Factories and workshops
(ii) Mines and minerals
(iii) Plantations
(iv) Transport, namely (a) Railways; *(b)* Seaman; (c) Ports and docks; (d) Inland water transport; (e) Motor transport; (f) Air transport
(v) Shops and commercial establishements

---

[3] V. V. Giri, *Labour Problems in Indian Industry* (Bombay: Asia Publishing House, 1972), p.157.

(vi) Contract labour
(vii) Construction works
(viii) Working journalists

III. Laws Relating to Specific Matters

(i) Wages
(ii) Indebtedness
(iii) Social Security-(a) Workmen's compensation;(b) Maternity benefits; (c) Retrenchment benefits; (d) Provident Fund and Bonus schemes
(iv) Bonus
(v) Forced labour

IV. Laws Relating to

(i) Trade Unions; and
(ii) Industrial relations

Laws Relating to Weaker Sections

The important legislative provisions with a bearing on the employment of children relate to minimum age of employment, working hours, health certification, employment on dangerous machines and the like. The Factories Act, 1948; the Mines Act, 1952; the Plantation Labour Act, 1951; the Employment of Children Act 1938; the Shops and Establishments Act of various States, etc., regulate the minimum age of employment. To ensure the physical fitness of children, the Factories Act provides that children upto the age of 18 will be employed on the production of a health certificate which will be valid for one year only. The Factories Act, the Mines Act, the Plantation Labour Act, the Shops and Establishments Acts, etc., prescribe the maximum hours of work allowed to be assigned to children.

The legislative provisions for the protection and welfare of women workers are largely inspired by the ILO Conventions on:

(i) Maternity Protection, 1919;
(ii) Night Work,1919;
(iii) Underground Work,1935;
(iv) Equal Remuneration, 1951; and
(v) Discrimination (Employment and Occupation), 1958.

However, the actual wording of the enactments in India in which the protection is written draws heavily on the Indian experience. Maternity benefits are provided under the Employees' State Insuranace Act and the Maternity Benefit Act, 1961. The other legislative meausre for women relate to certain restriction on the lifting of weight, employment in hazardous occupations, provision for separate toilet facilities, rest rooms, creches, etc.

Laws Relating to Specific Industries

Factories and Workshops: The Factories Act, 1948, which provides for the licensing, registration and inspection of factories, is meant to protect the interests of workmen, to ensure for them better conditions of work, and to prevent the employers from taking advantage of their weak bargaining power. It regulates the conditions of the employment of young persons and females, and provides for safe and healthy working conditions inside the factories.

The Industrial Employment (Standing) Orders Act, 1946, defines the rights and obligations of the employer and the workers in respect of recruitment, discharge, disciplinary action, holiday and leave, etc., with a view to reducing the friction between management and workers in industrial undertakings. The Act provides for the framing of *standing orders* in all industrial establishments (including factories, mines, railways, docks and plantations) employing 100 or more workers.

Mines and Minerals: According to the definition of the term "mine" under the Indian Mines (Amendment) Act n cast workings, railways, aerial ropeways, conveyors, tramways, slidings, workshops, power stations, etc., or any premises connected with mining operations and near or in the mining area. The Mines Act prohibits the employment of persons in a mine when its owner fails to comply with the notice of the Mines Inspectorate for remedying any matter connected with a mine which is dangerous to human life, limb or safety.

The Coal Mines (Conservation and Safety) Act, 1952, authorises the Central Government to take such meausres as it deems proper or necessary for the maintenance of safety in coal mines or for the conservation of coal. Other important laws in the field of mines and minerals are the Iron Ore Mines Labour Welfare Cess Act, 1961; Coal Mines Labour Fund Act, 1947; and Coal Mines Provident Fund and Bonus Schemes Act, 1948.

Plantations: The Plantation Labour Act,1951, regulates the conditions of work of plantation workers and provides for their welfare. The Act, which applies to tea, coffee, rubber and cinchona plantations, may be applied by State Governments to other plantations also. The Act, amended in 1981, provides for compulsory registration of plantations.

Transport: The working and service conditions of the employees of different transports are regulated by various laws, such as the Indian Railways Act, 1930; the Indian Merchant Shipping Act, 1973; the Indian Dock Labourers' Act, 1934; the Dock Workers (Regulation of Employment)Act, 1984; Marking of Heavy Packages Act, 1951; Motor Vehicles Act, 1939; and Motor Transport Workers Act, 1961.

Shops and Commercial Establishments: State Acts on shops and establishments broadly cover wage earners employed in shops, commercial establishments (including insurance and banking firms), restaurants, theatres, cinemas, and other places of publi; amusement. The Acts contain provisions related to opening and closing hours, hours of work, rest invervals, spread over, overtime rates and weekly holidays.

Contract Labour: Contract labour is generally employed for casual, seasonal or irregular work. The Contract Labour (Regulations and Abolition_ Act, 1970, seeks to abolish the contract labour systsem in perennial operations and regulates it where the system cannot be abolished. The Act is implemented both by the Centre and States. In the Central sphere contract labour has been prohibited for certain specified operations in coal, iron ore, limestone, dolomite and manganese mines, and in buildings owned or occupied by establishments under the Central Government.

The Act applies to every establishment which employs 20 or more workmen, and to every contractor who employs not less than 20 workers.

Construction Labour: To a limited extent, the Workmen's Compensation Act, 1923; the Minimum Wages Act, 1948 ; the Employees State Insurance Act,1948; the Contract Labour (Abolition and Regulation) Act, 1970; and Standing Instructions relating to casual labour applicable to the employing agencies apply to construction labour as well. It has, however, been noticed that these legislative enactments and standing orders do not cover safety at work and social security.

Working Journalists: The Working Journalists and Other Newspaper Employees (Conditions of Service) and Miscellaneous Provisions Act, 1955, regulates the conditions of service of working journalists and other persons employed in newspaper establishments. By a specific provision of this Act, the provisions of the Industrial Disputes Act with certain modifications have been applied to working journalists.

Laws Relating to specific Matters

Wages: The two important enactments for wages are the Payment of Wages Act, 1963, and the Minimum Wages Act, 1948.

The Payment of Wages Act ensures that industrial workers receive payment of their wages at regular intervals and that no unauthorised deductions are made from their wages.

The Minimum Wages Act empowers the appropriate Government to fix the minimum rate of wages payable to workers employed in all scheduled employments, which include employment in any woollen, carpet-making or shawl-weaving establishment, rice mill, flour mill, dal mill, oil mill as well as empolyment under any local authority.

Bonus: In the past, bonus was regarded as an *ex-gratia* payment made by the employer to his workers to provide a stimulus for extra effort by them in the production process. Sometimes it represented the desire of the employer to share with his workers the suplus generated by common endeavour and enterprise. However, later, bonus began to be looked upon as a "deferred wage" and the Payment of Bonus Act, 1965, by imposing a statutory liability upon the employer to pay bonus to the employees, has in effect accorded recognition to this view.

The Payment of Bonus Act applies to every factory as defined in the Factories Act, and to every other establishment in which 20 or more persons are employed on any day during an accounting year. Bonus is payable to employees drawing upto Rs. 2,500 per month.

Bonded Labour : The bonded labour system has been abolished all over the country by the Bonded Labour System (Abolition) Act, 1976. Under the Act, every bonded labourer stands freed and discharged from any obligation to render any bonded labour.

Laws Relating to Trade Unions and Industrial Relations

The law relating to the registration of trade unions and certain other matters is contained in the Trade Unions Act, 1926. The Act lays down the procedure for the registration of trade unions and defines very clearly their rights and liabilities. It specifies the objects on which a trade union may spend its general funds and provides for the constitution of a separate fund for political purposes. Members of bonafide registered trade unions have been granted protection against various civil and criminal liabilities which they are likely to incur in promoting and safeguarding their legitimate interests. More information is provided in the chapter on Trade Unions.

The various matters connected with industrial disputes are dealt with by the Industrial Disputes Act, 1947. The main objects are : To secure industrial peace by preventing and settling disputes and to ameliorate the conditions of workmen in industry.

The Act specifies all those cases when a strike or a lock-out shall be illegal and lays down the conditions necessary for the validity of lay-off and retrenchment of workers. It provides for the appointment of various conciliations authorities. The rights and powers of those authorities, the procedure of conciliation for the validity of settlements and awards have also been laid down by the Act. For details, see the chapter on Industrial Relations.

27

Labour Welfare and Social Security

The National Commission on Labour observes that the concept of "welfare" is necessarily dynamic, bearing a different interpretation from country to country and from time to time, and even in the same country, according to its value system, social institutions, degree of industrialization and general level of social and economic development.[1] The Directive Principles of State Policy in our Constitution refer generally to the promotion of the welfare of the people. In its specific application to the working class, securing just and humane conditions of work has been highlighted, but what these actually imply cannot be specified in rigid terms for all times.

In its Resolution of 1947, the ILO defined *Labour Welfare* as "such services, facilities and amenities as adequate canteens, rest and recreation facilities, arrangements for travel to and from work and for the accommodation of workers employed at a distance from their houses, and such other services amenities and facilities as contribute to improvements in the conditions under which workers are employed".[2]

The Governing Body of the ILO (Geneva, May-June, 1953) considered the subject and urged that it was essential to define precisely and closely the scope of labour welfare in view of the fact that it was a very wide subject, covered a very broad field and was not limited to any one industry or occupation. The ILO Recommendation No. 102 concerning the welfare for workers refers to :

(a) Facilities for food and meals in or near the undertaking;

(b) Rest and recreation facilities provided by the undertaking (excluding holiday facilities); and

---

[1] Government of India, Report of the *National Commission on Labour* (New Delhi : Manager of Publications , 1969), p. 111.

[2] Cited in Report of the *National Commission on Labour*, *Ibid.*, p. 112.

(c) Transportation facilities to and from the place of work where ordinary public transport is inadequate or impracticable.[3]

The study team appointed by the Government of Inida in 1959 to examine the labour welfare activities then existing divided the entire range of these activities into three groups, viz.,

(i) *Welfare within the precincts of an establishment*: medical aid, creches, canteens, supply of drinking water;

(ii) *Welfare outside the establishment*: provision for indoor and outdoor recreation, housing, adult education, visual instructions; and

(iii) *Social security*.

The committee of Experts on Welfare Facilities for Industrial Workers convened by the ILO in 1963 divided welfare services into two groups—(a) within the precincts of the establishment and (b) outside the establishment—but the total content of the activities was the same as that included in the three groups mentioned above.[4]

The classification adopted by the ILO is given below:[5]

Welfare and Amenities Within the Establishment

(i) Latrines and urinals;
(ii) Washing and bathing facilities;
(iii) Creches;
(iv) Rest shelters and canteens;
(v) Arrangements for drinking water;
(vi) Arrangements for prevention of fatigue;
(vii) Health service including occupational safety;
(viii) Administrative arrangements within a plant to look after welfare;
(ix) Uniforms and protective clothing; and
(x) Shift allowance.

Welfare Outside the Establishment

(i) Maternity benefits;
(ii) Social insurance measures, including gratuity, pension, provident fund and rehabilitation;
(iii) Benevolent funds;
(iv) Medical facilities, including programmes for physical fitness and efficiency, family planning and child welfare;
(v) Education facilities including adult education;

---

[3] *Ibid.*, p. 112.
[4] *Ibid.*, p. 112.
[5] *Ibid.*, p. 112.

(vi) Housing facilities;

(vii) Recreation facilities, including sports, cultural activities, library and reading room;

(viii) Holiday homes and leave travel facilities;

(ix) Workers' co-operatives, including consumers' co-operative stores, fair price shops and co-operative thrift and credit societies;

(x) Vocational training for dependants of workers;

(xi) Other programmes for the welfare of women, youth and children; and

(xii) Transport to and from the place of work.

Welfare and Amenities Within the Establishment

It is the employer's responsibility to provide facilities wihtin the precinets of an establishment, as they form a part of working conditions. This has also been the underlying principle of the policy adopted by the Government. For many components of such welfare, legislation in the country has set certain minimum standards. Improvements upon them have been left to the employers.

The facilities within the precincts of the establishment are regulated by the Factories Act, 1948, the Plantation Labour Act, 1951; and the Mines Act, 1952.

The Factories Act makes it obligatory on the employer to provide:

(i) Cool and clean drinking water; latrines and urinals; and washing and bathing facilities.

(ii) One first-aid box for every 150 employees.

(iii) Canteen in establishments which employ more than 250 workers.

(iv) Rest shelters or rest rooms and a suitable lunch room in all establishments employing 150 workers or more.

(v) Creches in factory establishments employing more than 50 women.

The Factories Act also requires the factories employing 500 or more workers to appoint a Labour Welfare Officer to look after the welfare of the workers.

State Governments have been empowered to frame rules to prescribe standards and to grant exemptions, wherever considered necessary. They have laid down elaborate standards for all welfare amenities, keeping in view mainly the requirements of all workers.

The Mines Act, 1952, has laid down provisions for drinking water, conservancy, first aid (including a first-aid room in every mine, wherein more than 150 persons are employed) and creche (in every mine employing women). The Mines rules provide that :

(i) An ambulance room shall have to be maintained under the charge of a qualified medical practitioner assisted by qualified staff on every mine employing 500 or more persons;

(ii) A shelter shall be constructed for taking food and rest at every mine employing 150 or more persons on any one day of the previous calendar year, as also near loading places, workshops or open cast workings in mines employing 25 or more persons; and

(iii) A canteen is to be provided in every mine employing 250 or more persons.

Drinking water, conservancy, medical facilities, canteen, creche, recreational facilities, and provision of umbrellas, blankets and raincoats have been made statutory by the Plantations Labour Act, 1951. A canteen has to be set up on plantations with 150 workers or more and a creche where 50 or more women are employed.

Certain welfare facilities are provided to workers in ports and docks under the Dock Workers (Safety, Health and Welfare) Scheme, 1961, which applies to all major ports and docks in the country. Housing, education and recreation facilities are provided for port workers by the Port Trusts with the Port Trust Employees' Welfare Funds. All the Dock Labour Boards have constituted Labour Welfare Funds to provide amenities, including medical and recreation facilities, for dock workers. Welfare facilities for workers employed in the workshop located in port areas are provided under the Factories Act, 1948.

The Motor Transport Workers Act, 1961, provides for the welfare of motor transport workers and for the regulation of their working conditions. The various schemes in operation include canteens, rest rooms, uniform hours of work and leave. The Act is administered by State Governments which have framed rules for its enforcement.

The bidi and cigar workers under the Bidi and Cigar Workers (Conditions of Employment) Act, 1966, and contract labour under the Contract Labour (Regulation and Abolition) Act, 1970, have also been provided with many of the facilities mentioned in the foregoing paragraphs.

Welfare Outside the Establishment

Welfare amenities outside the precincts of the establishment, such as medical, educational, recreational, housing and other facilities, are non-statutory in many cases. However, in plantations, the provision of some of them is obligatory on the employer.

Large establishments now pay attention to the above facilities. A number of large industrial enterprises also provide transportation facilities to their employees.

The Government have been trying to see that all industrial establishments employing more than 300 workers set up consumers' co-operative stores and fair price shops for their workers. A large number of industrial establishments have set up their own consumers' co-operative stores and fair price shops.

The importance of workers' education has been duly recognised by the Government. The Central Board for Workers' Education, set up in 1958, is a tripartite body, consisting of representatives of Central and State Governments, organizations of employers and workers and educationists. It is a registered society for the implementation of workers' education schemes with the following objectives :

(i) To equip all sections of workers for their intelligent participation in the socio-economic development of the nation;

(ii) To promote among workers a greater understanding of the problems of their socio-economic environment, their responsibilities towards family and their rights and obligations as citizens, as workers in industry and as members and officials of their trade unions;

(iii) To develop leadership from among the rank and file of workers themselves;

(iv) To create strong, united and more responsible trade unions through enlightened memebers and better trained officials;

(v) To strengthen democratic processes and traditions in the trade union movement; and

(vi) To enable trade unions themselves to take over ultimately the functions of workers' education.

The scheme of workers' education is divided into three stages. In the first stage, training is given to education officers who are full-time employees of the Board. In the second stage, the workers sponsored by trade unions are trained for three months by the education officers. These workers are called worker-teachers. In the third stage, the worker-teacher conducts the classes for other workers at their places of employment.

In 1977, the activities of the Borad were extended to the unorganised sector. Under the programme, seven pilot projects were started in 1977-78 at selected regional centres. The experience of these projects was encouraging and the Board has since decided to extend the programme to all the regional workers' education centres on a regular basis. The categories of workers covered are landless labourers, agricultural workers, rural artisans, forest and fisheries labour, marginal peasants and the educated unemployed in rural areas.

The Bord has established a number of regional centres to cover important industrial centres. It gives grants-in-aid to trade unions and institutions conducting workers' education programmes.

The National Safety Council was set up in March 1966. Its main function is to conduct seminars, organise film shows in factories, and distribute posters on the subject of safety.

Various schemes for the grant of National Safety Awards to factories, covered by the Factories Act, 1948, and ports have been instituted for good safety records. Each scheme consists of cash prizes and certificates of merit.

SOCIAL SECURITY

Modern Welfare States are expected to take care of the citizens from the "cradle to the grave". Resource constraints, however, do not permit many of them to completely accomplish this task. They, therefore, endeavour to look after the welfare of the individuals according to their capability. The Constitution of India, for instance, lays down that the State shall, within the limits of its economic capacity and development, make effective provisions for securing public assistance in the event of unemployment, old age, sickness, and disablement.

As the International Labour Organisation (ILO) states, social security envisages that the members of a community shall be protected by collective action against social risks causing undue hardship and privation to individuals whose private resources can seldom be adequate to meet them. It covers, through an appropriate organisation, certain risks to which a person is exposed. These risks are such that an individual of small means cannot effectively provide for them by his own ability or foresight alone or even private combination with his colleagues. [6]

In the words of the late Mr. V.V.Giri, who was a veteran trade union leader and who held top positions as Minister for Labour and President of India. "social security measures have a two-fold significance for evey developing country. They constitute an important step towards the goal of a Welfare State, by improving living and working conditions and affording the people protection against the uncertainties of the future. These measures are also important for evey industrialisation plan, for not only do they enable workers to become more efficient but they also reduce the wastage arising from industrial disputes. The man-days lost on account of sickness and disability also constitute a heavy drain on the slender resources of the worker and on the industrial output of the country. Lack of social security impedes production and prevent the formation of a stable and efficient labour force. Social security is, therefore, not a burden, but a wise investment in the long run." [7]

Mr. Giri points out that "in modern times, the active participation of the State in social security has resulted in two distinct methods of solving the

---

6. ILO, *Approaches to Social Security*, 1942, p. 80. (Cited in Government of India, *Report of the National Commission on Labour, Ibid.*, p. 162).

7. V.V. Giri, *Labour Problems in Indian Industry*, *op. cit.*, p. 271.

problem. The first method is that of social assistance, where the State or the local bodies step in to ameliorate the distress caused by these contingencies to the population in general. In this method, there are generally no contributory conditions. In concrete terms, social assistance includes non-contributory benefits towards the maintenance of children, mothers, invalids, the aged, the disabled and others. It also includes unemployment assistance. Social assistance can, therefore, be defined as a device for providing benefits, like exemption from taxation or general revenues, to persons of small means in amounts sufficient to meet a minimum standard of needs. The second method is that of social insurance, to which the persons concerned, their employers and the State, make contributions and mainly out of these contributions, benefits necessary to prevent want during unemployment, sickness, old age and other contingencies are given as a right, subject to certain qualifying conditions. In other words, social insurance can be defined as a device to provide benefits as of right for persons of small earnings, in amounts which combine the contributive efforts of the insured with subsidies from the employer and the State.

"The social insurance approach has grown from the system of friendly societies, which developed in Western countries and particularly in the United Kingdom during the last three centuries. The social assistance approach is the outcome of the Poor Laws, which also developed in these countries at the same time. In fact, in the United Kingdom, where social security is available to the entire population from the cradle to the grave, the main approach is that of social insurance, and persons are entitled to benefits by virtue of compulsory contributions. Those who are not qualified or can no longer get such benefits, are looked after by measures of social assistance.

"Present-day developments show that social insurance and social assistance are moving closer to one another. In fact, they even meet and combine as, for example, in New Zealand and Denmark, where it is difficult to say whether social insurance or social assistance predominates. Such countries have adopted a national system of social securities.

"To be equitable, measures of social assistance should provide for the population as a whole. The extent to which this can be done will depend on the level of national income; and in a developing country, this cannot be adequate. Measures of social insurance, on the other hand, depend very much more on the capacity of the individual industry. As such, it can be introduced in phases; first in more prosperous industries and later in less prosperous ones. In a country like India, where it is impossible at present to provide social security for the whole population, the main approach has to be that of insurance."[8]

---

[8] *Ibid.*, pp. 270-271.

Legislative Enactments

There are some important legislative enactments in India for the provision of social security. These enactments may be broadly classified into two categories :

(i) Acts that provide security in cases of employment injury, maternity and sickness; and

(ii) Acts that cover the risks of old age and unemployment.

The following three Acts come under the first category :

(i) The Workmen's Compensation Act, 1923;

(ii) The Maternity Benefits Act, 1961;

(iii) The Employees' State Insurance Act, 1948.

The Acts that come under the second category are :

(i) The Employees' Provident Fund and Family Pension Fund Act, 1952;

(ii) The Coal Mines Provident Fund, Family Pension and Bonus Act, 1948;

(iii) The Payment of Gratuity Act, 1972; and

(iv) The Industrial Disputes (Amendment) Act, 1956.

Workmen's Compensation

The Workmen's Compensation Act, 1923, amended several times, applies to workmen employed on monthly wages not exceeding Rs. 500 and who are employed in factories, mines, plantations, transport and construction work, railways and certain hazardous occupations. The Central and State Governments are empowered to extend the scope of the Act to any class of persons whose occupations are considered hazardous. Workers covered by the Employees' State Insurance Scheme are not entitled to benefits under the Workmen's Compensation Act.

The Act provides for the payment of compensation by employers to workmen and their dependents for personal injury caused by accidents arising out of and in the course of employment and for death or disablement as a result of contracting certain occupational diseases. The amount of compensation depends on the nature of the injury and the average monthly wages of the workmen. Compensation for death is payable to the dependents of workmen. The rate varies from a minimum of Rs. 1,000 for perosns in the lowest wage group to a maximum of Rs. 10,000 for persons in the highest wage group. Compensation for permanent and total disablement is payable in a lump sum, which varies from a minimum of Rs. 1,400. For temporary disablement, half monthly payments are made at the prescribed rates. No compensation is payable for temporary disablement for the waiting period of 3 days, but this period gets included if disablement lasts for 28 days or more.

The Act is administered by State Governments through Commissioners for Workmen's Compensation. The Commissioners are entrusted with the settling of disputed claims; the disposal of claims for injuries resulting in death; and the revision of the periodic payments.

Maternity Benefits

The Maternity Benefit Act, 1961, enacted with a view to achieving uniformity in matters relating to maternity protection, applies to all factories, mines and plantations, except to those to whom the Employees' State Insurance Act applies.

The Maternity Benefit Acts provide for the payment of cash maternity benefit for certain periods before and after confinement, and grant of leave and other facilities to women employees, on conditions prescribed in these Acts. The qualifying period of service varies from 5 to 9 months and the benefit is payable for a period of 8-12 weeks. Apart from the Central Maternity Benefit Act, 1961, which permits the payment of a medical bonus of Rs. 25, some State Acts include additional benefits, such as free medical aid, maternity bonus, provision of creches and additional rest intervals. In order to safeguard the interests of pregnant women workers, both the Central and State Acts provide that such women shall not be dismissed; nor can a woman worker be discharged during the period of maternity leave.

The Maternity Benefit Amendment Act, 1976, removes wage limit anomaly in the payment of maternity benefit to women employees covered under the ESI Act of 1948 by making them eligible under the Maternity Benefit Act of 1961.

The administration of the Acts in all the States is the responsibility of factory inspectorates. Whereas in the Coal Mines, the Coal Mines Welfare Commissioner is in charge of it the Director General of Mines Safety is in charge in mines other than coal.

Employees' State Insurance Scheme

The Employees' State Insurance Act, 1961, applies to all non-seasonal factories run with power and employing 20 or more persons, excluding mines and railway running sheds. The ESI scheme applies only to persons whose aggregate remuneration does not exceed Rs. 1,600 per month.

An insured person, entitled to benefits under this scheme, is not eligible to claim similar benefits under the Workmen's Compensation Act and the State Maternity Benefit Act.

The benefits provided by the ESI scheme are :

(i) Free medical treatment (including specialised services such as cardiological and pathological services) in cases of sickness and employment injury;

(ii) Free maternity care for women employees. The maternity benefit is admissible for 12 weeks, of which not more than 6 weeks may precede the expected date of confinement.

(iii) In the case of employment injury disabling the employee for more than seven days, a cash disablement benefit, which is roughly half the employees's wages for the duration of the disability, is allowed;

(iv) In the case of total permanent disablement, a life pension equal to about half the employee's wages, and in the case of partial but permanent disablement, a proportion of the amount that may fall due as life as life pension.

(v) If the injury proves fatal, the half-wage benefit takes the form of a pension for the family or dependants of the deceased.

The scheme is financed out of a fund built from contributions collected from employees and employers and grants from the Central and State Govermnenrts.

The Act is administered by a corporation in which employers, employees, the medical profession, the Central and State Governments and Parliament are represented. A Medical Benefit Council functions in an advisory capacity. A standing committee of the corporation is responsible for general supervision, but executive responsibility at headquarters lies with the Director-General.

To secure co-operation at all levels, regional boards and local committees have been set up, on which are representatives of labour, employers, State Governments and the corporation. In order to settle disputes speedily, the Act provides for the setting up of Employees' Insurance Courts by State Governments.

Provident Fund

While provident fund schemes were common in some government employments and with enlightened employers, the first legislative measure to cover industrial workers was the Coal Mines Provident Fund and Bonus Schemes Act, 1948. Though in the initial years the Act ran into opposition, both from employers and workers, after some time the misgivings on both sides were dispelled, and the Act got off to a good start.

Encouraged by the success of the Coal Mines Provident Fund Scheme and faced with the persistent demand made to the Central Government for the extension of similar benefits to workers employed in other industries, the Employees' Provident Funds was passed in 1952. (Since 1971, known as the Provident Funds and Family Pension Fund Act).

The Act provides insurance against old age, retirement, discharge, retrenchment or death of the workers. It is against these risks that the schemes guarantee the necessary protection to workers and their dependants. The Act and the scheme extend to the whole of India. It applies to factories and establishments falling under any notified industry, which have been in existence for at least 3 years, where the employment strength is 50 or more, and five years where the employment strength is 20 or more but less than 50. To become eligible for membership of the Fund, a worker must have completed one year's continuous service, or worked for 240 days during a period of 12 months. The employees have to contribute at the rate 6¼ per cent of the basic wage, dearness allowance and retaining allowances, if any, including the cash value of food concessions given to them. The employers too, have to contribute at the same rate. Workers, if they so desire, can contribute more, subject to a maximum of 8 $^1/_3$ per cent. With effect from January 1, 1963, the statutory rate of provident fund contribution has been raised to 8 per cent in respect of certain industries/classes of establishments employing 50 or more persons in a few specified industries.

Withdrawals from the Fund are regulated as follows :

(i) A member is entitled to withdraw the full amount standing to his credit in the following circumstances :

(a) On retirement from service after attaining his age of 55 years.

(b) On retirement because of permanent and total incapacity to work due to bodily or mental infirmity duly certified by the medical officer of the establishment, or where an establishment has no regular medical officer, by a registered medical practitioner.

(c) Immediately before migration from India for permanent settlement abroad.

(d) On termination of service in the case of mass or individual retrenchment.

(ii) In cases other than the above, the Central Board, or, where so authorised by the Central Board, the Commissioner, or where so authorised by the Commissioner, any officer subordinate to him, may permit a member, subject to the provisions set out below, to withdraw the amount standing to his credit in the Fund under each of the follwoing circumstances:

(a) If he, being a national of country other than India, is leaving India at least for a year.

(b) If he has not been employed in any factory or other establishment to which the Act applies for a continuous period of not less than six months immediately preceding the date on which he makes an application for withdrawal.

When a member withdraws the amount standing to his credit in the aforesaid circumstances, mentioned in (ii) above, the amount of the employer's contribution and interest thereon shall be forfeited to the exent specified below :

(i) If the period of membership of the Fund is less than 3 years, 75 per cent of the amount of the employer's contribution and interest thereon shall be forfeited.

(ii) If the period of membership of the Fund is 3 years or more but less than 5 years, 50 per cent of the amount of the employer's contribution and interest thereon shall be forfeited.

(iii) If the period of membership of the Fund is 5 years or more but less than 10 years, 25 per cent of the amount of the employer's contribution and interest thereon shall be forfeited.

(iv) If the period of membership of the Fund is 10 years or more, but less than 15 years, 15 per cent of the amount of the employer's contribution and interest thereon shall be forfeited.

The scheme is administered by a Central Board of Trustees, consisting of the representatives of the Central and State Governments, employers and workers. Twenty regional offices have been set up, each under a regional commissioner, who has inspectors and other staff under him. The regional commissioner is the chief executive officer of the Board. There are also regional committees, whose function is to advise the Central Board.

Lay-off and Retrenchment Compensation

The Indusrial Disputes Act of 1947 was amended in 1953 to provide for the payment of compensation in the event of lay-off or retrenchment.

Workers, employed in any factory, mine or plantation having an average daily employment of 50 or more where the work done is not of an intermittent or seasonal character, are entitled to compensation for lay-off, provided that they have put in the prescribed qualifying service in the preceding twelve calendar months.

A workman laid off is entitled to get compensation according to the following rules :

(i) A workman laid off will be paid compensation by the employer for all the days during which he is so laid off except for such weekly holidays as may intervene.

(ii) The rate of compensation shall be equal to fifty per cent of the total basic wages and dearness allowance that would have been payable to him had he not been so laid off.

(iii) A workman laid off shall be entitled to compensation only when—

(a) He is not a *badli* workman or a casual workman. *Badli* workman means a workman who is employed in an industrial establishment in the place of another workman whose name is borne on the muster rolls of the establishment. A *badli* workman shall cease to be regarded as such on the completion of one year of continuous service in the establishment.

(b) His name appears on the muster rolls of the industrial establishment.

(c) He has completed not less than one year of continuous service.

Unlike the lay-off provision, the benefits of retrenchment compensation are applicable to all the workmen covered by the Act. No workman, who has been in continuous service in any industry for not less than one year, can be retrenched by an employer until one month's notice (or wages in lieu thereof) has been given to him in writing, indicating the reasons for the retrenchment. Retrenchment compensation is payable at the rate of 15 days' average pay for every completed year of service or any part thereof in excess of six months. In the event of *bonafide* closures or transfer of undertakings, retrenchment compensation shall be payable to workers so laid-off. In the event of a change of ownership, such workers as have been re-employed on the terms and conditions which are not less favourable to them shall not be entitled to compensation.

Family Pension

To provide long-term financial security to the families of industrial employees in the event of their premature death, the Coal Mines Family Pension Scheme, 1971, and the Employees' Family Pension Scheme, 1971, were introduced from March 1, 1971. The schemes are financed by diverting a portion of the employers' and employees' contribution to the Employees' Provident Funds with an additional contribution by the Central Government.

This scheme, which came into force on March 1, 1971, applies to employees of all factories and other establishments to which the above Act applies. The Act, however, does not apply to factories and establishments which provide for the employee a family pension at a scale considered by the Central Government not less favourable on the whole than the one provided under the scheme. The amount of family pension payable ranges from a minimum of Rs. 60 to the maximum of Rs. 320 per month.

Gratuity Scheme

The Payment of Gratuity Act, 1972, provides for the payment of gratuity to an employee drawing Rs. 1,600 or less per month as wages. The Act is applicable to —

(i) Every factory, mine, oilfield, plantation, port and railway company; these words have the meaning as assigned to them under the relevant provisions of the Factories Act, 1948; the Mines Act, 1952; the Oilfields (Regulation and Development) Act, 1948 ; the Plantations Labour Act, 1951; the Indian Ports Act, 1908 ; and the Indian Railways Act, 1890, respectively:

(ii) Every shop or establishment within the meaning of any law for the time being in force in relation to shops and establishments in a

State in which ten or more persons are employed, or were employed, on any day of the preceding twelve months; and

(iii) Such other establishments or class of establishments, in which ten or more employees are employed, or were employed, on any day of the preceding twelve months, as the Central Government may by notification, specify in this behalf. In exercise of these powers, the Central Government has specified motor transport undertakings as defined in Section 2 *(g)* of the Motor Transport Workers Act, 1961, provided 10 or more persons are employed therein.

Gratuity is payable at the rate of 15 days' wages (basic wage + dearness allowance) for every completed year of service. The ceiling on this is 20 months' wages. In case of misconduct of the employee, which involves financial loss to the management, an amount equal to the loss directly suffered by the employer by reason of such misconduct is liable to be forfeited from the gratuity due to the employee. The Act also provides for the punishment of the employer who fails to pay gratuity to an employee. Thus, gratuity has now become a statutory service condition, and its quantum has no bearing on the size of the profit of the organisation or similar extraneous consideration.

28

Industrial Relations

Meaning

The term *industrial relations* is so broad that it is not amenable to a precise definition. We may, however, state that *the core of industrial relations is the various aspects of interactions between employer and employees, employees and employees, employers and employers,* and between the state, employers and employees. Professor Richardson observes: "How people get on together at their work, what difficulties arise between them, how their relations, including wages and working conditions, are regulated, and what organisations are set up for the protection of different interests — these are some of the main problems of industrial relations and indicate the wide scope of the subject."[1] "Industrial relation," observes V.B. Singh, "are an integral aspect of social relations arising out of employer-employee interaction in modern industries, which are regulated by the State in varying degrees, in conjuncture with organised social forces and influenced by the existing institutions. This involves a study of the State, the legal system, and the workers' and employers' organisations at the institutional level; and of patterns of industrial organisation (including management), capital structure (including technology), compensation of the labour force, and a study of market forces-all at the economic level."[2]

Professor J.T. Dunlop of Harvard University views industrial relations in a very broad perspectives.[3] According to him, industrial relations should not be taken as one which denotes union-management relations operating within the spectrum of industrial peace or conflict. On the other hand, it should be taken as one which is concerned with the larger subject of an industrial relations system which defines the role, status and the conduct of different groups of people who work together for productive purposes in an economy characterised by its peculiar social and economic conditions prevailing in a given technological, market and power context, giving rise to the creation of a body of rules to govern the interactions of the different groups of people involved therein. To quote him : "An industrial relations system at any one time in development is regarded as comprised of certain actors, certain contents, an ideology which binds the industrial relations system together; and a body of rules created to govern the actors at the work place and work community."[4]

---

[1] J.H. Richardson, *An Introduction to Industrial Relations* [Cited in S. Nagaraju, *Industrial Relations System in India* (Allahabad : Chugh Publication, 1981), p. 1].

[2] V.B. Singh, *Climate for Industrial Relations* [Cited in C.B. Mamoria, *Personnel Management* (Bombay: Himalaya Publishing House, 1982), p. 754].

[3] [illegible] *Model of Industrial Relations System and its application at a regional level in India, see S. Nagraju, Industrial Relations System in India, op. cit.*

INDUSTRIAL DISPUTES

Meaning

According to the Industrial Disputes Act, 1947, the term "*industrial dispute" means any dispute or difference between employers and employers, or between employers and workmen, or between workmen and workmen, which is connected with the employment or non-employment, or the terms of employment or with the conditions of labour, of any person.*

In the literature on industrial relations, the words *dispute* and *conflict* are used more or less as synonyms. However, there is a difference between *unrest* and *dispute*. Unrest is "psychological in nature and the disputes are concrete evidence of unrest. Disputes constitute open manifestations of the feeling of dissatisfaction, disputes are the overt expression."[5] Thus, as Dr. Nagaraju observes, industrial unrest "refers to the discontent or dissatisfaction lurking in the disturbed minds of labourers, about certain lapses at the work place or about their wages or security of employment, etc. Labourers are always hopeful that their causes of discontent or unrest can be eliminated by their collective strength. Hence, they form their own organisation and resort to certain measures with which they try to gain their ends. Since industrial unrest involves questions of right or wrong and also affects every section of society, it thrusts itself upon the attention of the community and becomes a social problem. That is the reason why in all industrial conflicts, the public is viewed as an important factor."[6]

CAUSES OF INDUSTRIAL DISPUTES

There are a number of causes of industrial dispute. A dispute may be caused by any one or more of these many factors. Some of these factors are so intertwined that sometimes it is not possible to segregate and categorise them definitely. The common causes have been adumbrated below:

---

[4] Cited in S. Nagaraju, *Industrial Relations System in India, op. cit.*, p. 2.

[5] S. Nagaraju, *Industrial Relations System in India, op. cit.*, p. 23.

[6] *Ibid.*, p. 24.

Conflict of Interests

Needless to say, all disputes emerge from one or other type of conflict of interest. Though the employer and employees are integral parts of the same organisation, many a time the strategies of each party are guided by its own vested interests, the interests of one affecting those of the other. As Dr. Nagaraju points out[7], though there is a large area in which the interests of employers and employees are the same, there are at least three areas in which conflict is certain to occur.

First, there is the conflict of interests over the division of the total product of the industry. For instance, there are a number of instances of industrial disputes caused by the labour's demand for higher bonus on the ground that the enterprise has been making substantial profits. This is one instance of labour and capital coming into conflict on the issue of sharing what the enterprise mops up from the market.

Second, as Srivastava points out, there is the conflict between the humanitarian rights of the workers and the property rights of the employers.[8] Labour wants to have a healthy and pleasant working environment, including good behaviour of the supervisors. But if the employer, in his eagerness to maximise profits, does not care for the human factor, a conflict of interests is bound to arise.

Third, as Butler observes, there is a continuing conflict between the efficiency aspirations of the management and the security aspirations of the workers.[9] For instance, where rationalisation or automation leads to retrenchment of labour, it is likely to cause a dispute.

Economic Causes

Especially in the developing countries, where the monetary rewards for work are meagre, economic causes are the most important source of industrial disputes. We have already hinted at a few of the economic causes under the "Conflict of Interests" dealt with above. We may now more specifically state the important economic causes of industrial disputes.

Wages: The demand for higher wages is one of the most important sources of industrial conflict. An examination of the causes of industrial disputes in India shows, that in most of the years, in about one-third of the total number of disputes, the main issue was wages and allowances. The common reasons for a demand for higher wages and allowances are:

(i) Workers may feel that their wages do not correspond to their output or the work they do, including the risks involved in the nature of their work.

---

[7] *Ibid.*, p. 25.

[8] K.N. Srivastava, *Industrial Peace and Labour in India* (Cited in S. Nagaraju, *Ibid.*, p. 26).

[9] A.D. Butler, *Labour Economics and Labour Institutions* (Cited in S. Nagaraju, *Ibid.*, p. 26).

(ii) Existing wages are insufficient to provide a reasonable standard of living.

(iii) Wages and allowances have not increased sufficiently to offset the increase in the cost of living.

(iv) Wages and allowances may be lower than those of the workers in other comparable enterprises or industries.

(v) Differences of income between industrial workers and the property-owning class and the differences in the distribution of wealth.

(vi) The feeling that the enterprise has the capacity to pay higher wages (even when the wages are comparatively better).

Bonus: Another important issue on which disputes crop up is bonus. Despite the *Payment of Bonus Act*, disputes over the rate of bonus, etc., have been common. Bonus was the cause of nearly 7 per cent of the total number of industrial disputes in India in 1961, over 14 per cent in 1971, 8.4 per cent in 1981 and 4.7 per cent in 1982.

Economic Insecurity: Sometimes industrial disputes crop up following the demand of labour for economic security. The most important economic security for the worker is his job. It is, then, natural that labour should try its best to protect its jobs. It is the feeling of insecurity that leads labour into a strike against retrenchment and dismisals and for a permanent status for temporary workers. Industrial disputes are also caused by a demand for social security benefits.

Working Conditions and Labour Welfare

Workers have come to believe that they have a right to good working conditions. Working conditions include the length of the working day, the interval and frequency of leisure, physical work environment, including safety measures.

As stated in a previous chapter, the term *labour welfare* refers to "such services, facilities and amenities, and adequate canteen, rest and recreation facilities, arrangements for travel to and from work and for the accommodation of workers employed at a distance from their houses, and such other services such as — amenities and facilities as contribute to improvements in the conditions under which workers are employed."

Personnel Factors

Poor personnel administration may also cause industrial disputes. In the absence of effective personnel management, grievances and unrest, which can be solved at the incipient stage, may spark off a dispute. V.V. Giri observes : "The services of personnel officers are called for only when a dispute arises, and their role prior to that is lost sight of. While they are useful in solving disputes, they would be far more valuable in preventing the occurrence of a dispute, if their services are properly utilised. By regularly keeping themselves in touch with labour and interpreting to them the policies of the management and also appraising the employers of the possible reactions of labour to their various schemes, personnel officers would be able to restrict, to a great extent, the nature and number of disputes in the industries."[10]

Psychological Factors

As Patterson remarks: "There are human or psychological causes of labour conflict as well as material or market causes. A worker's satisfaction with the job is based only partly on his wages, hours of work or other conditions of employment. It is also based upon the extent to which he enjoys his work and feels that it is worthwhile."[11] Such psychological factors as denial of opportunity to the worker of satisfying his basic urge for self-experession, personal achievement and betterment may cause unrest and labour problems.

External Factors

External factors refer to those causes which are not directly connected with the industrial establishment. For example, if the workers of an establishment strike work in support of, or to express sympathy for, the strikers in some other establishment, it is an external factor.

One of the important external factors is the political factor. Labour may strike work to protest against certain legislative measures or Government policies, to support certain social and political movements, or even to change a political regime.

Industrial Dispute in India

The total number of mandays lost due to strikes and lock-outs increased from 4.92 million in 1961 to 16.55 million in 1971 and 36.58 million in 1981. In 1982, the number was 77.4 million and 44.3 million in 1983, including the mandays lost due to Bombay textile strike which were estimated at 44.2 million in 1982 and 19.3 million in 1983. In most years, a majority of the mandays were lost because of strikes. The number of mandays lost due to strikes and lock-outs in 1991-92 was about 34 million and 19.2 million in 1994-95.

INDUSTRIAL DISPUTES — PREVENTIVE STEPS

As prevention is better than cure, no effort should be spared to prevent the occurrence of industrial disputes. Preventive measures may be taken at the enterprise level and at the macro level.

Employer-Employee Relations

At the enterprise level, a good personnel management and cordial employer-employee relationship contribute to industrial peace. The participation of labour in management, a good employer-employee communication system, a proper understanding of the situation by both the parties, mutual respect for each other's rights, a proper discharge of the responsibilities by both the parties, etc., are very important if conflicts and disputes are to be avoided. There should be a proper procedure for the settlement of individual grievances so that they may not ultimately lead to disputes.

---

[10] V.V. Giri, *op, cit.*, p. 121.

[11] Cited in S. Nagaraja, *op. cit.*, p. 30.

Tripartite Machinery

Certain general measures have been taken to prevent disputes and to promote industrial peace, such as the establishment of a number of tripartite bodies, the adoption of the Code of Discipline, and the Industrial Truce Resolution.

The term *tripartite machinery* refers to the various bodies, composed of representatives of employers, employees and the Government, set up for the promotion of industrial peace. The important tripartite bodies are the following:

(i) *The Indian Labour Conference* which is concerned with such matters as the promotion of uniformity in labour legislation, in the procedures for the settlement of industrial disputes, etc.

(ii) *The Standing Labour Committee*, which considers all those matters referred to it by the Indian Labour Conference (ILC) or by the Central Government, including the suggestions of State Governments, employers and employees bearing on labour affairs.

(iii) *The Industrial Committees*, which discuss the specific problems of industries for which they have been set up, and submit their reports to the ILC, which co-ordinates their activities.

(iv) *The Central Implementation and Evaluation Committees*, which are concerned with the effective implementation of labour laws, awards, settlements, etc.

(v) *The Committee on Conventions*, which examines the ILO conventions and recommendations, and explores the possibility or advisability of ratifying them and applying them to Indian conditions.

Code of Discipline and Industrial Truce Resolution

The central organisations of employers and workers adopted the Code of Discipline in 1958. To ensure better discipline in industry, the Code lays down that:

(i) There shall be no strike or lock-out without notice;

(ii) No unilateral action shall be taken in connection with any industrial matter;

(iii) The existing machinery for the settlement of disputes should be utilised with the utmost expedition;

(iv) Neither party will have recourse to coercion, intimidation and lock-out;

(v) They will avoid litigation, sit-down and stay-in strikes and lock-outs;

(vi) No deliberate damage shall be done to plant and machinery;

(vii) Awards and agreements should be speedily implemented;

(viii) Any action which disturbs cordial industrial relations should be avoided.

The Industrial Truce Resolution, which was adopted in 1962, provides that there should be maximum recourse to voluntary arbitration, and envisages that all complaints pertaining to dissmissal, discharge, victimisation and retrenchment of individual workmen, not settled mutually, should be settled by arbitration.

SETTLEMENT OF DISPUTES

There are statutory and non-statutory methods for the settlement of industrial disputes

If the dispute can be settled by non-statutory methods, the employer-employee relations might continue to be cordial. Under statutory methods, the settlement is sometimes imposed rather than willingly accepted.

Sometimes an amicable settlement may arise out of negotiation and discussion directly between management and employees. When this is not possible, a third party, like a Government representative, may mediate and try to bring the parties to a mutual agreement.

Voluntary Arbitration

V.V. Giri, who regarded compulsory adjudication as Enemy Number One of collective bargaining and industrial peace, had great faith in the virtues of arbitration on voluntary basis. The Code of Discipline adopted by the central organisations of employers and workers in 1958 and the Industrial Truce Resolution of 1962 stressed the significance of voluntary arbitration. The spirit of voluntary arbitration is to settle disputes mutually and without recourse to legal remedies, for "it is essentially the existence of a spirit of give-and-take amongst employers and workers which is a *sine qua non* for the maintenance of peace between the two parties."

The merits attributed to voluntary arbitration are:

(i) It is less time-consuming;

(ii) It is less expensive than adjudication;

(iii) It avoids litigation which so often occurs in adjudication cases;

(iv) It promotes goodwill and confidence between the parties to the dispute;

(v) The award of the voluntary arbitrator is generally accepted with better spirit than under compulsory arbitration;

(vi) It promotes collective bargaining and the democratic spirit.

SETTLEMENT OF INDUSTRIAL DISPUTES — MACHINERY UNDER THE INDUSTRIAL DISPUTES ACT

The statutory machinery for the settlement of industrial disputes has been provided by the *Industrial Disputes Act, 1947*, amended from time to time (significantly in 1982). The important authorities which constitute the machinery for the settlement of industrial disputes under the Act have been discribed below.

Grievance Settlement Authority

The I.D. Act provides that the employer shall, in every industrial establishment in which 50 or more workers are employed, provide for, in accordance with the rules made in that behalf under the Act, a Grievance Settlement Authority (GSA) for the settlement of industrial disputes connected with an individual workman employed in the establishment.

When an industrial dispute connected with an individual workman arises in such an establishment, the workman or any trade union of workmen of which such workman is a member, may refer, in such manner as may be prescribed, such dispute to the GSA provided for by the employer for the settlement.

The GSA shall follow such procedure as may be prescribed and complete the proceedings within such period as may be prescribed.

No reference shall be made with respect to any such dispute to any other authority under the Act unless such dispute has been referred to the GSA and the decision of the GSA is not acceptable to either of the parties to the dispute.

Conciliation Officers

The I.D. Act provides that the appropriate Government* may, by a notification in the Official Gazette, appoint such number of persons as it thinks fit to be conciliation officers, charged with the duty of mediating in and promoting the settlement of the industrial dispute.

A conciliation officer may be appointed for specified area, or for specified industries in a specified area, or for one or more specified industries, either permanently or for limited period.

Duties of Conciliation Officers

(i) Where any industrial disputes exists or is apprehended, the conciliation officer may (or where the dispute relates to a public utility service and a notice for strike or lock-out has been given in accordance with the provisions of the Act, the conciliation officer shall) hold conciliation proceedings in the prescribed manner.

---

* It may be stated, generally, that under the I.D. Act, in relation to any industrial disputes concerning a Central Government establishment, the appropriate Government is the Central Government and in most other cases, the State Government concerned is the appropriate Government.

(ii) The conciliation officer shall, for the purpose of bringing about a settlement of the dispute without delay, investigate the dispute and all matters affecting the merits and the right settlement thereof, and may do all such things as he thinks fit for the purpose of inducing the parties to come to a fair and amicable settlement of the dispute.

(iii) If a settlement of the dispute or of any of the matters in dispute is arrived at in the course of the conciliation proceedings, the conciliation officer shall send a report thereof to the appropriate Government (or an officer authorised in this behalf by the apropriate Government), together with a memorandum of the settlement signed by the parties to the dispute.

(iv) If no such settlement is arrived at, the conciliation officer shall, as soon as practicable after the close of the investigation, send to the appropriate Government a full report, setting fourth the steps taken by him for ascertaining the facts and circumstances relating to the dispute and for bringing about a settlement thereof, together with a full statement of such facts and circumstances and the reasons on account of which, in his opinion, a settlement could not be arrived at.

(v) If, on a consideration of the report referred to in sub-section (iv), the appropriate Government is satisfied that there is a case for reference to a Board of Conciliation, Labour Court, Tribunal or National Tribunal, it may make such a reference. Where the appropriate Government does not make such a reference, it shall record and communicate to the parties concerned its reasons therefor.

(vi) A report under this section shall be submitted within fourteen days of the commencement of the conciliation proceedings or within such shorter period as may be fixed by the appropriate Government:

Provided that, subject to the approval of the conciliation officer, the time for the submission of the report may be extended by such period as may be agreed upon in writing by all parties to the dispute.

Board of Conciliation

The I.D. Act provides that the appropriate Government may, as occasion arises, by notification in the Official Gazette, constitute a Board of Conciliation to promote the settlement of an industrial dispute.

The Board shall consist of a chairman and two or four other members, as the appropriate Government thinks fit. The chairman shall be an independent person and the other members shall be persons appointed in equal numbers to represent the parties to the dispute, and any person appointed to represent a party shall be appointed on the recommendation of that party. However, if any party fails to make a recommendation as aforesaid within the prescribed time, the appropriate Government shall appoint such persons as it thinks fit to represent that party.

Duties of Board

(i) Where a dispute has been referred to a Board under this Act, it shall be the duty of the Board to endeavour to bring about a settlement of the same, and for this purpose the Board shall, in such manner as it thinks fit and without delay, investigate the dispute and all matters affecting the merits and the right settlement thereof and may do all such things as it thinks fit for the purpose of inducing the parties to come to a fair and amicable settlement of the dispute.

(ii) If the settlement of a dispute or of any of the matters in dispute is arrived at in the course of the conciliation proceedings, the Board shall send a report thereof to the appropriate Government, together with a memorandum of the settlement signed by the parties to the dispute.

(iii) If no such settlement is arrived at, the Board shall, as soon as practicable after the close of the investigation, send to the appropriate Government a full report, setting forth the proceedings and steps taken by the Board to ascertain the facts and circumstances relating to the dispute and to bring about a settlement thereof, together with a full statement of such facts and circumstances, its findings thereon, the reasons on account of which, in its opinion, settlement could not be arrived at and its recommendations for the termination of the dispute.

(iv) If, on the receipt of a report under sub-section (iii) in respect of a dispute relating to public service, the appropriate Government does not make a reference to a Labour Court, Tribunal or National Tribunal under Section 10, it shall record and communicate the parties concerned its reasons therefor.

(v) The Board shall submit its report under this section within two months of the date on which the dispute was referred to it, or within such shorter period as may be fixed by the appropriate Government.

Provided that the appropriate Government may, from time to time, extend the time for the submission of the report by such further periods not exceeding two months in the aggregate;

Provided further that the time for the submission of the report may be extended by such period as may be agreed on in writing by all the parties to the dispute.

Courts of Inquiry

The I.D. Act provides that the appropriate Government may, as occasion arises, by notification in the Official Gazette, constitute a Court of Inquiry to enquire into any matter appearing to be connected with or relevant to an industrial dispute.

A court may consist of one independent person or of such number of independent persons as the appropriate Government may think fit and where a Court consists of two or more members, one of them shall be appointed as the Chairman.

A Court shall inquire into the matters referred to it and report thereon to the appopriate Government ordinarily within a period of six months from the commencement of its inquiry.

Labour Courts

The appropriate Government may, by notification in the Official Gazette, constitute one or more Labour Courts to adjudicate industrial disputes relating to any matter specified in the Second Schedule and to perform such other functions as may be assigned to them under the Act. A Labour Court shall consist of "one person only to be appointed by the appropriate Government."

Tribunals

The appropriate Government may, by an order in the Official Gazette, constitute one or more Industrial Tribunals to adjudicate an industrial dispute relating to any matter, whether specified in the Second Schedule or Third Schedule, and to perform such other functions as may be assigned to them under this Act. A Tribunal shall consist of one person only to be appointed by the appropriate Government.

National Tribunals

The Central Government may, by notification in the Official Gazette, constitute one or more National Industrial Tribunals to adjudicate an industrial dispute which, in the opinion of the Central Government, involve questions of national importance or are of such a nature that industrial establishments situated in more than one State are likely to be interested in, or affected by, such disputes. A National Tribunal shall consist of one person only to be appointed by the Central Government. The Central Government may, if it so thinks fit, appoint two persons as assessors to advise the National Tribunal in the proceedings before it.

Duties of Labour Courts, Tribunals and National Tribunals: Where an industrial dispute has been referred to a Labour Court, Tribunal or National Tribunal for adjudication, if shall hold its proceedings expeditiously and shall within the period specified in the order referring such industrial dispute, or within the further period extended under the provisions of the Act, submit its award to the appropriate Government.

Reference and Awards

Where the appropriate Government is of the opinion that any industrial dispute exists or is apprehended, it may at any time, by an order in writing, refer the dispute or any matter appearing to be connected with it to the concerned authority.

Where an industrial dispute has been so referred to the concerned authority, the appropriate Government may by an order prohibit the continuance of any strike or lock-out in connection with such dispute which may be in existence on the day of reference.

There is also a provision in the Act for voluntary reference of disputes to arbitration if the employer and the workman agree to that.

The award of the concerned authority on the dispute shall be in writing and shall, within a period of thirty days from the date of its receipt by the appropriate Government, be published in such manner as the appopriate Government thinks fit.

An award shall become enforceable on the expiry of thirty days from the date of its publication. However, the appropriate Government may declare that the award shall not become enforceable on the expiry of the said period of thirty days if it thinks that it will be expedient so to do on public grounds affecting national economy or social justice. Where such a declaration has been made, the appropriate Government may, within ninety days from the date of the publication of the award, make an order rejecting or modifying the award, and shall, on the first available opportunity, lay the award, together with a copy of the order, before the State legislature or Parliament, as the case may be.

Prohibition of Strikes and Lock-outs

The Act prohibits strikes and lock-outs in public utilities without sufficient notice, as specified in the Act. It also prohibits strikes and lock-outs during the pendency of proceedings relating to the dispute before the concerned authority and a certain specified period after that. Further, strikes and lock-outs are prohibited during any period in which a settlement or award is in operation in respect of any of the matters covered by the settlement of the award.

Where a strike or lock-out in pursuance of an industrial dispute has already commenced and is in existence at the time of the reference of the dispute to the authority, the continuance of such strike or lock-out shall not be deemed to be illegal, provided that such strike or lock-out was not at its commencement in contravention of the provisions of this Act and the continuance thereof was not prohibited under the Act. Further, a lock-out declared in consequence of an illegal strike or a strike declared in consequence of an illegal lock-out shall not be deemed to be illegal.

The Act also provides that no person shall knowingly expend or apply any money in direct furtherance or support of any illegal strike or lock-out. Any person who violates this shall be punishable with imprisonment for a term which may extend to six months, or with fine upto Rs. 1,000, or both.

Other Important Provisions of the Act

The Industrial Disputes Act lays down the conditions of lay-off and retrenchment; the right of workmen laid-off for compensation; the procedure for closing down an undertaking; the compensation for workmen in the event of the closure of undertakings; and penalties for illegal strikes and lock-outs, instigation, breach of settlement or award, disclosing confidential information, closure without notice and other offences.

The Act also lays down that no employer or workmen or a trade union shall commit any unfair labour practice. Any person who commits any unfair labour practice shall be punishable with imprisonment for a term which may extend to six months or with fine which may extend to Rs.1,000, or both.

APPENDIX 28.1

SCHEDULES TO THE INDUSTRIAL DISPUTES ACT

THE FIRST SCHEDULE

Industries which may be declared to be Public Utility Services under Sub-clause (vi) or clause (n) of Section 2

1. Transport (other than railways) for the carriage of passengers of goods [by land or water];
2. Banking;
3. Cement;
4. Coal;
5. Cotton textiles;
6. Foodstuffs;
7. Iron and steel;
8. Defence establishments;
9. Service in hospital and dispensaries;
10. Fire Brigade service;
11. Indian Government Mints;
12. India Security Press;

13. Copper Mining;
14. Lead Mining;
15. Zinc Mining;
16. Iron Ore Mining;
17. Service in any oil field.

THE SECOND SCHEDULE

Matters within the Jurisdiction of Labour Court

1. The propriety or legality of an order passed by an employer under the standing orders;
2. The application and interpretation of standing orders;
3. Discharge or dismissal of workmen, including reinstatement of, or grant of relief to, workmen wrongfully dismissed;
4. Withdrawal of any customary concession or privilege;
5. Illegality or otherwise of a strike or lock-out; and
6. All matters other than those specified in the Third Schedule.

THE THIRD SCHEDULE

Matters within the Jurisdiction of Industrial Tribunals

1. Wages, including the period and mode of payment;
2. Compensation and allowances;
3. Hours of work and rest intervals;
4. Leave with wages and holidays;
5. Bonus, profit sharing, provident fund and gratuity;
6. Shift working, otherwise than in accordance with standing orders;
7. Classification by grades;
8. Rules of discipline;
9. Rationalisation;
10. Retrenchment of workmen and closure of establishment; and
11. Any other matter that may be prescribed.

THE FOURTH SCHEDULE

Conditions of Service for Change of which Notice is to be Given

1. Wages, including the period and mode of payment;
2. Contribution paid, or payable, by the employer to any provident fund or pension fund or for the benefit of the workmen under any law for the time being in force;
3. Compensation, and other allowances;
4. Hours of work and rest intervals;
5. Leave with wages and holidays;
6. Starting, alteration or discontinuance of shift working otherwise than in accordance with standing orders;
7. Classification by grades;
8. Withdrawal of any customary concession or privilege or change in usage;
9. Introduction of new rules of discipline, or alteration of existing rules, except in so far as they are provided in standing orders;

10. Rationalisation, standardisation or improvement of plant or technique **which is** likely to lead to retrenchment of workmen;

11. Any increase or reduction (other than casual) in the number of persons employed or to be employed in any occupation or process or department or shift not occasioned by circumstances over which the employer has no control.

THE FIFTH SCHEDULE*

Unfair Labour Practices

I. On the part of employers and trade unions of employers

1. To interfere with, restrain from, or coerce, workmen in the exercise of their right to organise, form, join or assist a trade union or to engage in concerted activities for the purposes of collective bargaining or other mutual aid or protection, that is to say-

(a) threatening workmen with discharge or dismisal, if they join a trade union;

(b) threatening a lock-out or closure, if a trade union is organised;

(c) granting wage increase to workmen at crucial periods of trade union organisation, with a view to undermining the efforts of the trade union organisation.

2. To dominate, interfere with or contribute support, financial or otherwise, to any trade union, that is to say:

(a) an employer taking an active interest in organising a trade union of his workmen; and

(b) an employer showing partiality or granting favour to one of several trade unions attempting to organise his workmen or to its members, where such a trade union is not a recognised trade union.

3. To establish employer-sponsored trade unions of workmen.

4. To encourage or discourage membership in any trade union by discriminating against any workman, that is to say:

(a) discharging or punishing a workman, because he urged other workmen to join or organise a trade union;

(b) discharging or dismissing a workman for taking part in any strike (not being a strike which is deemed to be an illegal strike under this Act);

(c) changing seniority rating of workmen because of trade union activities;

(d) refusing to promote workmen to higher posts on account of their trade union activities;

(e) giving unmerited promotions to certain workmen with a view to creating discord amongst other workmen, or to undermine the strength of their trade union;

(f) discharging office-bearers or active members of the trade union on account of their trade union activities.

5. To discharge or dismiss workmen;

(a) by way of victimisation;

(b) not in good faith, but in the colourable exercise of the employer's rights;

(c) by falsely implicating a workman in a criminal case on false evidence or on concocted evidence;

(d) for patently false reasons;

(e) on untrue or trumped up allegations of absence without leave;

---

* The Fifth Schedule was inserted by Act No. 46 of 1982, [illegible]

(f) in utter disregard of the principles of natural justice in the conduct of domestic enquiry or with undue haste;

(g) for misconduct of a minor or technical character, without having any regard to the nature of the particular misconduct or the past record or service of the workman, thereby leading to a disproportionate punishment.

6. To abolish the work of a regular nature being done by workmen, and to give such work to contractors as a measure of breaking a strike.

7. To transfer a workman *male fide* from one place to another, under the guise of following management policy.

8. To insist upon individual workmen, who are on a legal strike, to sign a good conduct bond, as a pre-condition to allowing them to resume work.

9. To show favouritism or partiality to one set of workers regardless of merit.

10. To employ workmen as "badlis", casuals or temporaries and to continue them as such for years, with the object of depriving them of the status and privileges of permanent workmen.

11. To discharge or discriminate against any workman for filing charges or testifying against an employer in any enquiry or proceeding relating to any industrial dispute.

12. To recruit workmen during a strike which is not an illegal strike.

13. Failure to implement award, settlement or agreement.

14. To indulge in acts of force or violence.

15. To refuse to bargain collectively, in good faith, with the recognised trade unions.

16. Proposing or continuing a lock-out deemed to be illegal under this Act.

II. On the part of workmen and trade unions of workmen.

1. To advise or actively support or instigate any strike deemed to be illegal under this Act.

2. To coerce workmen in the exercise of their right to self organisation or to join a trade union or refrain from joining any trade union, that is to say —

(a) for a trade union or its members to picketing in such a manner that non-striking workmen are physically debarred from entering the work places;

(b) to indulge in acts of force or violence or to hold out threats of intimidation in connection with a strike against non-striking workmen or against managerial staff.

3. For a recognised union to refuse to bargain collectively in good faith with the employer.

4. To indulge in coercive activities against certification of a bargaining representative.

5. To stage, encourage or instigate such forms of coercive actions as wilful "go slow", squatting on the work premises after working hours or "gherao" of any of the members of the managerial or other staff.

6. To stage demonstrations at the residences of the employers or the managerial staff members.

7. To incite or indulge in wilful damage to employer's property for acts connected with the industry.

8. To indulge in acts of force or violence or to hold out threats of intimidation against any workman with a view to preventing him from attending work.

29

Workers' Participation in Management

Meaning

Though the concept of *workers' participation in management* has become very popular, it is very difficult to define it clearly, for there are various forms and levels of participation, ranging from the role of workers limited to making suggestions on certain matters which are not very important to active involvement in decision-making and administration.

As the International Institute of Labour Studies remarks, "The participation results from practices which increase the scope for employees' share of influence in decision-making at different tiers of the organisational hierarchy with concomitant assumption of responsibility."[1] We should hasten to add here the apt remark of group of practising managers that "workers' participation in management is involvement of workers only in such areas of activities of the enterprises where they can make some positive contribution."[2] If the workers' mental and emotional involvement in decision-making and execution of programmes should be substantial, workers' participation may be defined as a "principle of ensuring industrial democracy through mutual understanding, faith, trust and co-operation of workers and managements by establishing an effective communication system for attaining the whole-hearted involvement of each worker in the area of his competence and concern with a view to maximising results in regard to the achievement of the organisational goals and individual well-being."[3]

---

1. Cited in V.P. Michael, *Industrial Relations in India and Workers' Involvement in Management* (Bombay : Himalaya Publishing House, 1970), p. 168.
2. Cited in V.P. Michael, *Ibid.*, p. 168.
3. V.P. Michael, *Ibid.*, p. 169.

However, as mentioned earlier, the form and extent of workers' participation in management varies widely. In some cases, it is limited to making suggestions on certain matters, whereas, at the other extreme, workers are represented on the Board of Directors so that they are a part and parcel of decision-making and administration; in some cases, even the whole management of the enterprise is vested in the workers.

Objectives

The objectives of workers' participation in management may vary from country to country and from enterprise to enterprise. However, the various objectives may be listed as follows:

(i) To promote industrial peace;
(ii) To promote industrial democracy;
(iii) To give due recognition to the personality of the workers;
(iv) To safeguard the interest of workers;
(v) To regulate the self-centred actions of the capitalists;
(vi) To give a social orientation to the business;
(vii) To ensure the best utilisation of the human resources;
(viii) To improve employee morale;
(ix) To satisfy workers' urge for self-expression;
(x) To improve industrial productivity.

Problems and Limitations

Workers' participation in management, however, poses certain problems and has some limitations.

(i) Workers may not be competent enough to understand and appreciate the managerial aspects of the enterprise. This is particularly so in developing countries.

(ii) It has been argued that workers are more bothered about labour welfare and the like than about the growth, dynamics and challenging problems of the enterprise.

(iii) It is possible that the workers' representative in the management may be an outsider — a politician or a trade union leader. To that extent, the "real" participation or involvement of the workers is limited.

(iv) The possibility of the workers' representative on the Board falling in line with the capitalists against the interests of the workers cannot be completely ruled out.

(v) The worker-management collaboration may sometimes turn against the interest of society. The capitalist may get the support of labour to exploit the consumers. Labour may lend its support to the capitalist in this respect if it can also share the enlarged cake.

Forms of Participation

As mentioned earlier, the forms and levels of labour participation in management may vary widely between countries and between enterprises. The nature of participation depends on a number of factors, such as the socio-political attitudes and situation, the attitudes of management and labour, labour-management relations, the relative strengths of labour and management, the peculiarities of the industry or enterprise, etc. Further, "there could be various forms of managerial decisions in social, personnel and economic matters which have an impact on the work force of an enterprise. Some decisions, especially economic ones, can be taken only at the higher level where basic policies are decided. There are also some decisions at the middle and lower levels concerning the formulation and execution of policies, especially in the area of social and personnel matters."[4] Accordingly, "workers' participation in management will have to be at different levels and in different forms. Workers may be given an opportunity to influence or take part in managerial decisions at the higher level through their representatives on Supervisory Boards or the Board of Directors or through Work Councils. Participation may also be at lower levels at which workers are given some authority to plan and take decisions about their work, like job-enrichment, job-enlargement delegation, etc. Workers may participate in managerial decisions through collective bargaining. They may also participate informally through the participative style of supervision. Some consider that workers' participation in ownership is also a form of participation. However, it has to be realised that participation in the result of an enterprise through profit sharing or some schemes does not, in the real sense mean participation in management."[5]

The common forms of workers' participation in management are the following:

(i) Collective Bargaining: It is common to decide certain matters, especially those which have direct economic significance for workers, on the basis of collective bargaining. The growth of trade unionism, the workers' awareness of their rights and strength, and the recognition of the importance of negotiations by labour and management have contributed to the growth of collective bargaining. Some of the common subject matters of collective bargaining are wages, bonus, working conditions, and welfare matters.

(ii) Joint Consultation: The functions of joint bodies, comprising representatives of the management and employees, may range from decision making on some issues to merely advising the management as consultative

---

[4] B.R. Virmani, *Workers' Participation in Management* (Delhi: The Macmillan Co. of India Ltd., 1978), p. 9.

[5] *Ibid.*, p. 9.

bodies. Joint consultation as a form of WPM is common in countries like India and Britain. The essential features of the Joint Management Councils in India are:

(a) The Council is entitled to be consulted on certain specified matters;

(b) In some others, the management is expected to share information with the Council; and, in a set of functions, administrative responsibilities have to be given to it.

Though the Joint Management Councils/Committees have been tried in some countries, they have, generally, "not been found effective. There is a certain amount of lack of clarity of objectives. Moreover, being advisory or consultative bodies, neither the management nor the workers take them seriously. Often, they merely work as forums where workers and management freely vent their complaints and grievances without solving them. Some consider that unless these joint committees are vested with powers to take binding decisions, they will remain ineffective. There are others who feel that such joint committees should not be given authority to take decisions on such issues as are normally the concern of the management. In such a case, joint management committees would be accused of shedding their advisory role and becoming a kind of management body instead; and no sooner does Committee become managerial, there would be need for a new consultative body.[6]

(iii) Joint Decision-Making and Administration: For the purposes of joint decision making and administration, the workers are represented on the Board of Directors. Sometimes the worker representative's role is limited to participating in decision-making; but the actual execution of the programmes is the responsibility of the management. In the area of joint administration, however, workers and management share the responsibility and power of execution. In India, the scheme of worker-directors has been introduced, both as a statutory arrangement in nationalised banks as well as a voluntary one in selected Central public enterprises. As Virmani observes, though "legally the workers' representative on the Board may have all the rights and obligations like the other members of the Board, his ability to participate in managerial decision-making, to a large extent, will depend on his quality, his knowledge of company affairs, his educational background, his level of understanding and also on the number of worker representatives on the Board. Most of the decisions in which the workers are interested are normally made at the lower levels of management."[7]

---

[6] *Ibid.*, pp. 13-14.

[7] *Ibid.* p. 11.

(iv) Complete Control of Management: In some cases, like the system of *self-management* in Yugoslavia, workers have complete control over the management of the enterprise. Under the system in Yugoslavia, the workers have the option to influence all the decisions taken at the top level; but in actual practice, the Board and the top management team assume a fairly independent role in taking policy decisions for the enterprise, especially on economic matters. The system of complete control of management cannot. obviously, fit into a capitalistic system. A potential danger of compl control of management by the workers is that, like capitalists, the workers might try to maximise their benefits even at the expense of the consumers or society.

(v) Workers' Participation in Share Capital: As the Sachar Committee observes, workers' participation in equity and in management are in some sense inter-related from the point of view of attaining the ultimate goal of co-partnership in industry. In favour of the workers' participation in share capital, it has been said that, besides giving them a sense of dignity and status as co-partners, equity participation secure for them a share in the company's future prosperity while holding out promises for improved industrial relations and steady growth of internal finances for the company's operations. It has also been said that the improved performance of industry and harmonious industrial relations pave the way for the ultimate gain of the community as well as of the State.

The majority view of the *Sachar Committee* is that in all future issues of shares by the companies, they should reserve a portion of new shares, say, about 10 to 15 per cent, exclusively for the workers, to be called workers' shares. These shares in the first instance must be offered to the employees of the company, and, failing that, they should be offered to the existing shareholders or to the public. The Committee suggested that, for this purpose Section 81 of the Companies Act should be suitably amended.[8]

WORKERS' PARTICIPATION SCHEMES IN INDIA

The Government of India is of the view that, at the enterprise level, workers' participation in management should become an integral part of the industrial relations system to serve as an effective instrument of modern management, and that it should be made a vehicle for transforming the attitudes of both employers and workers with a view to establishing a co-operative culture which may help in building a strong, self-confident and self-reliant country with a stable industrial base.

The Directive Principles of State Policy, enshrined in the Indian Constitution, lays down: "The State shall take steps, by suitable legislation or in any other way, to secure the participation of workers in the management of undertakings, establishments or other organisations engaged in any industry" (Article 43A). Some of the Five-Year Plan documents and industrial policy statements have also mentioned the importance of labour participation in management.

---

[8] Government of India, *Report of the High-Powered Expert Committee on Companies & MRTP Acts*, p. 93.

Various measures have been tried in India to promote workers' participation. Starting with the limited scheme of statutory Works Committees, voluntary arrangements were made in the form of joint management councils, the scheme of worker-directors, both as statutory arrangements in nationalised banks as well as a voluntary one in selected Central public enterprises; and voluntary schemes of workers' participation in the manufacturing/mining industries introduced in 1975 and in commercial and service organisations in the public sector introduced in 1977.

Works Committees/Joint Committees

The Industrial Disputes Act, 1947, provides for the setting up of a Works Committee, consisting of representatives of management and employees, in every undertaking employing 100 or more workmen "to promote measures for securing and preserving amity and good relations between the employer and workmen and, to that end, to comment upon matters to their concern and endeavour to compose any material difference of opinion in respect of such matters." The representatives of the workmen, whose number shall not be less than the number of representatives of the employer, are to be chosen from among the workmen engaged in the establishment and in consultation with their recognised trade union, if any.

The usefulness of the works committees as a channel for joint consultation and the need for strengthening and promoting this institution was stressed in the labour policy statements in the successive Plans. The legal requirement and encouragement given by the Government led to the setting up of works committees in a number of undertakings. The works committees, however, did not prove effective. The vagueness in the legal definition of the scope and functions of the Committees was a major reason for this ineffectiveness. To remedy this defect, the Indian Labour Conference in 1956 drew up an illustrative list of items which works committees would normally deal with, and a list of items which would be beyond their scope. The former included consultation on:

(i) The conditions of work, such as ventilation, lighting, temperature and sanitation, including latrines and urinals;

(ii) Amenities, such as drinking water, canteens, dining rooms, rest rooms, medical and health services;

(iii) Safety and accident prevention, occupational diseases and protective equipment;

(iv) Adjustment of festival and national holidays;

(v) Administration of welfare and fine funds;

(vi) Educational and recreational activities;

(vii) Promotion of thrift and savings; and

(viii) Implementation and review of decisions arrived at in meetings of works committees.

The items specifically excluded were discussion on:

(i) Wages and allowances;

(ii) Bonus and profit-sharing bonus;

(iii) Rationalisation and matters connected with the fixation of the work load;

(iv) Matters connected with the fixation of a standard labour force;

(v) Programmes of planning and development;

(vi) Matters connected with retrenchment and lay-off;

(vii) Victimisation for trade union activities;

(viii) Provident fund, gratuity schemes and other retirement benefits;

(ix) Quantum of leave, and national and festival holidays;

(x) Incentive schemes; and

(xi) Housing and transport services.

In spite of these clarifications, the works committees have not, generally, proved very successful.

Reasons for Failure: In the evidence before the National Commission on Labour (NCL), State Governments expressed the view that the advisory nature of the recommendations, vagueness regarding their exact scope and functions, inter-union rivalries, union opposition, and reluctance of employers to utilise such media have rendered works committees ineffective. The employers' associations have attributed the failure of works committees to factors like inter-union rivalries, union antipathy, and the attitude of members (workers' wing) in trying to raise in the committee discussion on extraneous issues. According to the unions, conflict between the works committees and the unhelpful attitude of the employers had generally led to their failure.

Suggestions: The NCL indicated that the effectiveness of these committees will depend on the following factors:

(a) A more responsive attitude on the part of the management;

(b) Adequate support from unions;

(c) A proper appreciation of the scope and functions of the works committees;

(d) Whole-hearted implementation of the recommendations of the works committees; and

(e) Proper co-ordination of the functions of the multiple bipartite institutions at the plant level.

Joint Management Councils

The Scheme of joint management councils (JMCs) is based on a draft prepared by the tripartite committee appointed by the 15th Session of the Indian Labour Conference, as subsequently modified by two tripartite national seminars on the subject held in 1958 and 1960.

Objectives: The main objectives in the establishment of JMCs were:

(i) To promote cordial relations between management and workers;

(ii) To build up understanding and trust between management and workers;

(iii) To effect a substantial increase in productivity;

(iv) To secure better welfare and other facilities for workers; and

(v) To train the workers to understand and to share the responsibilities of management.

Functions of JMC: The essential features of the scheme of JMC are:

(i) The Council is entitled to be consulted on certain specified matters;

(ii) In some others, the management is expected to share information with the Council; and

(iii) In a set of functions, administrative responsibilities have to be given to it.

(a) The Councils would be consulted by the management on such matters as:

(i) The administration of Standing Orders and their amendment, when needed;

(ii) Retrenchment;

(iii) Rationalisation; and

(iv) Closure, reduction in, or cessation of, operations.

(b) The Council/Councils would also have the right to receive information, to discuss and to give suggestions on

(i) The general economic situation of the concern;

(ii) The state of the market, production and sales programmes;

(iii) The organisation and general running of the undertaking;

(iv) The circumstances affecting the economic position of the undertaking;

(v) The methods of manufacture and work;

(vi) The annual balance sheet and profit and loss statement and connected documents and explanation;

(vii) Long-term plan for expansion, re-deployment; and

(viii) Such other matters as may be agreed to.

(c) The Councils would be entrusted with administrative responsibility in respect of:

(i) Administration of welfare measures;

(ii) Supervision of safety measures;

(iii) Operation of vocational training and apprenticeship schemes;

(iv) Preparation of schedules of working hours and breaks and of holidays;

(v) Payment of rewards for valuable suggestions received from the employees; and

(vi) Any other matter.

(d) All matters, e.g., wages, bonus, etc., which are subjects for collective bargaining, are excluded from the scope of the Council/Councils. In short, the creation of new rights as between employers and workers should be outside the jurisdiction of the Management Council. Individual grievances are also excluded from its/their scope.

Shop/Departmental Councils and Joint Councils

In October 1975, the Government announced a model scheme for workers' participation in management. This scheme, meant for implementation in all manufacturing and mining enterprises employing 500 or more workers, envisaged shop councils at shop/departmental levels and a joint council at the enterprise level.

The two councils were to have an equal number of representatives of the employers and employees. The representatives of the workers on the councils were to be nominated by the management, in consultation with the unions, from amongst the workers actually engaged in the enterprise. All decisions of a shop council should be on the basis of consensus and not be a process of voting, provided that either party might refer the unsettled matters to the joint council for consideration. Every decision of the shop council is to be implemented within a month, unless otherwise provided in the decision itself.

The main functions of the shop council are to help management in achieving production targets, improving productivity; assist in maintaining general discipline in the shop, attend to physical conditions of working, welfare and health measures, and to ensure a proper flow of adequate two-way communication between the management and the workers, particularly on matters relating to production schedules and the progress in achieving the targets.

The main functions of the joint council are fixation of productivity norms, dealing with the unresolved problems referred to it by the shop councils, awarding of rewards for creative suggestions from workers, ensuring optimum use of raw materials, ensuring the quality of finished products, etc.

The issues thrown up by the working of the scheme of 1975 were discussed at a tripartite labour conference held in May 1977. On the recommendations of the conference, a committee on Workers' Participation in Management and Equity, consisting of representatives of central organisations of employers and trade unions, of some of the States and professional institutions of management, was appointed in September 1977. The report of the committee submitted to the Government showed that a majority of the members favoured adoption of a three-tier system of participation, viz., at the corporate level, at the plant level and at shop-floor level. The committee laid down the detailed functions of the various councils at shop, plant and corporate levels. It recommended that the workers' representatives on the participative forums should be elected by secret ballot. It also recommended that equity participation should be optional. Further, it recommended that an organisation be set up, both at the Centre and in the States, to monitor the implementation of the scheme and review its working.

The Government introduced a new and comprehensive scheme for the workers' participation *vide* Resolution dated 30-12-1983 in Central public sector undertakings. The State Governments have been requested to introduce it in their enterprises and the private sector has also been encouraged to introduce the scheme.

The issue of WPM was discussed by the Indian Labour Conference in November 1986 and the conference agreed in principle to the implementation of the scheme of workers' participation in public, private and co-operative sectors.

30

Quality Circles

Origin and Development

Quality Circle is a participative management concept that has been gaining more and more popularity. Although it is in Japan that this concept was concretised and demonstrated its enormous potential for contribution to increase in productivity and employee morale building, its rudimentary origin is traced to the United States where problem-solving groups have existed since the 1930s.

The quality circles developed in Japan in the 1960s. Much of their development was due to the early work of the American experts Joseph Juran and Edward Deming both of whom made frequent trips to Japan in the 1950s. "Deming emphasised statistical quality control while Juran emphasised the advantages of good group process in getting quality improvement suggestions from employees. During the late 1950s and early 1960s, many large Japanese Corporations began to take quality improvement seriously. As part of their strategy to improve product quality, they made widespread use of employee problem-solving groups called quality control circles."

The quality circle in its form known today "was conceived and introduced by Dr. Kaoru Ishikawa, a Japanese Chemical Engineer Quality Control expert, when he was an Advisor with JUSE (Union of Japanese Scientists and Engineers) in 1962.

The role played by quality circles in transforming the Japanese industry, generally characterised by low quality of the products, to one which excels in quality and low cost has made the quality circles very popular in other countries too.

The quality circle concept took birth in India in 1980 when this concept was introduced in the Hyderabad unit of the Bharat Heavy Electricals Ltd.

(BHEL). The growing popularity of the quality circles in India is evident from the increase in the number of organisations which have quality circles.

Q.Cs have become universal. They find application in almost every field of human activity : industry, offices, hospitals and service organisations, family etc.

Meaning and Nature of Q.C.

A quality circle is "a voluntary group of people who meet together on a regular basis to identify, analyse and solve quality, productivity, cost reduction, safety and other problems in their work area, leading to improvement in their performance and enrichment of their worklife."[1]

The generally regarded ideal size of a Q.C. is around ten members. As every member of the Circle is expected to actively participate in the Q.C. meetings, a large number is not good. Too small a number of members would tend to make the circle dormant.

Ideally members of a particular Circle should be from the same work-area or who do similar work, so that the problems they discuss will be familiar to all of them.

An organisation may have a number of Q.Cs. For example, the Appolo Tyres in Kerala has twelve Q.Cs.

If the number of workers of any particular department / section who volunteer to join the Q.C. is more than the ideal number that one Q.C. can accomodate, two or more circles may be formed in the same area. Thus, an organisation could have one or more Q.C. in every department or section. There are organisations where all the workers have become members of Q.Cs.

Fig. 30.1 shows the structure of organisation of quality circles.

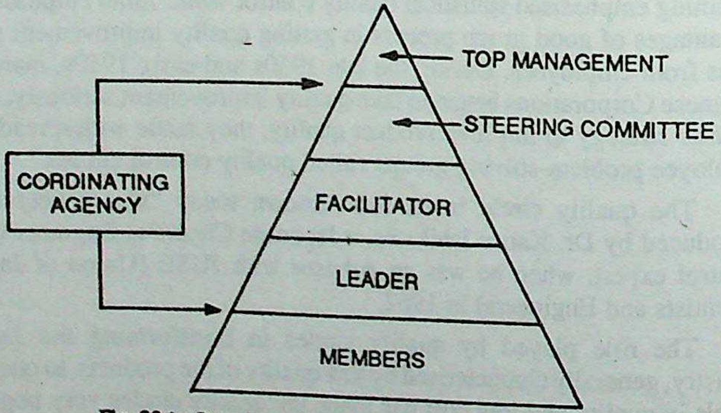


Fig. 30.1 : Structure of organisation of quality circle

---

[1] Quality Circle Forum of India, *Quality Circle*, 1990, p. 3.

(i) *Top Management*: For the success of quality circles, earnest support of the top management is essential.

(ii) *Steering Committee*: The Steering Committee usually consists of the heads of major departments of the organisation and is presided over by the Chairman who is preferably the Chief Executive of the organisation. Facilitators are invited to the Steering Committee for giving brief reports on the functioning of the circles in their respective areas.

The Steering Committee sets the goals and objectives for the quality circle activities which establishes operational guidelines and takes an overview of the quality circle activities.

(iii) *Facilitator*: The facilitator is a senior official nominated by the management responsible for facilitating and guiding Q.C. activities in his area. The facilitator's functions include liaisoning with the coordinator on all aspects of Q.C. activities execution of all Q.C. policies. procedures and code of conduct; upward and downward communications in respect of Q.Cs. etc.

(iv) *Leader*: Every quality circles must have a leader whose functions include encouraging members to actively participate in the circle activities, ensuring proper conduct of the Q.C. meetings, making regular progress reports and maintaining circle records, providing agenda for the meeting etc.

Leader is elected by the members. In many cases, a supervisor or foreman is initially chosen as the leader.

(v) *Members*: Members are the group of workers who have voluntarily formed quality circle. Workers who are not members of Q.Cs are called non-members. The members are the core of the quality circle.

Objectives/Philosophy of Q.Cs

The objectives/philosophy of the quality circles are the following.[2]

(i) Reduce errors and enhance quality and productivity.
(ii) Inspire more effective team work.
(iii) Promote job involvement and participation.
(iv) Increase employee motivation.
(v) Create problem solving capability.
(vi) Build an attitude of "problem prevention."
(vii) Improve communication in the organisation.

---

[2] *Ibid.*, pp. 4-5.

(viii) Develop harmonious manager-worker relationship.

(ix) Promote personal and leadership development.

(x) Develop a greater safety awareness.

(xi) Promote cost reduction.

(xii) Catalyse attitudinal changes for greater cohesiveness and teamwork.

The Process of Q.Cs

As indicated earlier, a quality circle is a group of people who meet at regular intervals, say once in a week or fortnight, to solve work related problems. The process involves the following:

(i) *Identification of Problems*: The members may be able to identify several problems in their area. Quality, productivity, cost reduction, housekeeping and safety are but some of the general categories of problems which may be identified by Q.C. Techniques such as brain storming may be used to help problem identification.

(ii) *Problem Selection*: Problem selection is a prerogative of the Circle. When several problems are identified, a selection of problem(s) for the further process of the Q.C. may become necessary.

(iii) *Problem Analysis*: The circle members analyse the selected problems. If needed, the circle may take the assistance of experts and consultants.

(iv) *Recommendation to the Top Management:* Finally, the circle makes its recommendations to its departmental heads in the first instance, normally once in 7-8 weeks, and selected cases of all circles are presented to the top management, normally once in 2-3 months (known as management presentation). In a management presentation, the leader and members describe to their manager what project they have been working on and what recommendations they wish to make concerning it.

It is the top management who decides whether the recommendation should be accepted and implemented.

Conditions for Success of Q.Cs

The success of quality circles depend on a number of factors like the following:

(i) Active support and commitment from the part of top management.

(ii) Proper coordination.

(iii) Commitment and ability of facilitators and leaders.

(iv) Proper education about the quality circle philosophy and sufficient training for facilitators, leaders and members.

(v) Systematic development of the quality circle movement. Only limited number of circles shall be started initially and the number should be increased gradually. Starting many circles initially or increasing the number very rapidly may cause problems of lack of concentration, coordination etc.

(vi) The first circles to start should be in those areas with scope for quick, tangible and easily visible results.

Reasons for Failure of Q.Cs

The important reasons for failure of Q.Cs are:

(i) Lack of commitment and support from the top management.

(ii) Lack of ability or commitment of facilitators and leaders.

(iii) Lack of sufficient education about Q.C. philosophy and training to members, leaders and workers.

(iv) Opposition from trade unions.

(v) Wrong notions about Q.C.

Conclusion

Many organisations have realised savings running into lakhs of rupees due to the implementation of suggestions of quality circles. There are enough evidences to show that quality circles can produce immence tangible and intangible benefits. These include cost reduction, improvements in operational methods, waste reduction, quality improvement, improvement in productivity, improvement in interpersonal communications, improvement in employee morale and labour-management relations, reduction in mandays lost, increase in profits etc.

However, there are also many cases of failures of quality circles because of the absence of the conditions necessary for their success mentioned above. There are also many cases of circles which were successful becoming dormant later. Absence of proper motivation, or a change in the top management resulting in lack of top management commitment to Q.C. etc. could be reasons for this.

Quality circles are just a fad as far as a some managements are concerned.

The concept of quality circles does not envisage any direct monetary benefit to the members. Mainly because of this, some people argue that it is a management tactic to exploit the workers. It is not a right argument.

The workers may materially benefit from the quality circles. Some organisations have reward system for good employee suggestions. If the financial position of an organisation improves because of quality circles, it may enable the organisation to spend more on employee welfare, increase bonus etc. Further, if the Q.C. helps prevent an enterprise from becoming sick that would save the workers from becoming unemployed by preventing the closure of the unit due to sickness.

Quality circle is primarily "a people building philosophy and not people using."

Quality circle "is one concept which combines *humanistic, scientific*, and *spiritual* principles in its content and working, thus making it a *concept* and *philosophy.*"[3]

Quality circles can play a great role in improving quality, increasing productivity, production and improving the health and competitiveness of the industrial and services sectors of India. It can greatly help in realising the potentials of the individuals working in an organisation, elevating the status of workers, improving interpersonal relations, improving employee morale and happiness, and improving industrial relations.

---

[3] P.K. Aravindan, *Quality Circle — A Glimpse*, p. 4.

31

Trade Unions

Meaning

Under the Trade Unions Act, the expression *trade union* includes both employers' and workers' organisations.

According to the Indian Trade Unions Act, 1926, a "Trade union means any combination, whether temporary or permanent, formed primarily for the purpose of regulating the relations between workmen and employers, or between workmen and workmen, or between employers and employers, or for imposing restrictive conditions on the conduct of any trade or business, and includes any federation of two or more trade unions." The Act does not, however, affect-

(i) Any agreement between partners as to their own business;

(ii) Any agreement between an employer and those employed by him as to such employment;

(iii) Any agreement in consideration of the sale of the goodwill of a business or of instruction in any profession, trade or handicraft.

The term *trade union*, however, is commonly used to refer to the organisation of workers formed to protect their rights and to enhance their welfare. In this chapter, the discussion is limited to the organisation of workers. According to V.V. Giri : "Trade unions are voluntary organisations of workers formed to promote and protect their interests by collective action."[1] A trade union "must possess definite aims; its members must be welded together in a united front for the good of the whole group rather than for the promotion of any slefish individual interests; and it must, to be effective, take on a definite and permanent form of organisation through which it strives to accomplish its goal".[2]

---

[1] V.V. Giri *op. cit.*, p.1.

[2] Gordons Watkins and Paul A. Dodd, *Labour Problems* (cited by V.V. Giri, *ibid.*)

Functions of Trade Unions

Trade unions are intended to protect the rights and enhance the welfare of the members in particular and of the working class in general. According to the National Commission on Labour (NCL), the important functions of the trade unions are:

(i) To secure for workers fair wages;
(ii) To safeguard security of tenure and improve conditons of service;
(iii) To improve opportunities for promotion and training;
(iv) To improve working and living conditions;
(v) To provide for educational, cultural and recreational facilities;
(vi) To co-operate in and facilitate technological advance by broadening the understanding of workers of its underlying issues;
(vii) To promote identity of interests of the workers with their industry;
(viii) To offer responsive co-operation in improving levels of production and productivity, discipline and high standard of quality; and, generally,
(ix) To promote individual and collective welfare.

Social Responsibilities of Trade Unions

It is not uncommon that the organised might of the trade unions holds public life to ransom as pressure tactics to serve their purpose, throwing civil rights and liberties to the winds. While the unions have the right to fight for their rights, it is high time that they realised that they have no right to use their organised might to deny the unorganised innocent public their legitimate rights

As the NCL observes, it is imperative that unions keep the well-being and progress of the community constantly before them even in the midst of their endeavours to help the working class. Unions have a stake in the success of the national plans for economic development, since these are formulated and implemented as much for maximising production as for distributing the product in an equitable manner. Unions have to adapt themselves to changing social needs, and rise above the divisive forces of caste, religion and language. In this context, some important social responsibilities of trade union appear to be in the field of:

(i) Promotion of national integration;
(ii) Generally influencing the socio-economic policies of the community through active participation in their formulation at various levels; and
(iii) Instilling in their members a sense of responsibility towards industry and the community.

According to the late Mr. V.V.Giri, a veteran trade unionist, "the scope of trade unions should not be confined merely to the workers' demands, but should include the inculcation in the workers of a sense of discipline and responsibility, an appreciation of their moral responsibility to do a fair day's work for a fair day's wages. The unions should make every worker understand fully, first, his duties and responsibilities and, then, his rights and privileges. This means that the objects of a trade union should be such as to instil in the individual worker a spirit of self-reliance, toleration and co-operation. In fact, in a society which is well set on the road to socialism and in which the workers' claim to proper wages and good working conditions receives constant attention, the worker has substantial responsibilities which he should fully understand and discharge. Socialism requires the establishment of an industrial democracy, which in turn calls for discipline on the one hand and sincere and efficient work on the other."[3]

TRADE UNION MOVEMENT IN INDIA

Though the trade union movement in India had its germination in the last quarter of the nineteenth century, it was only in the first quarter of the twentieth century that the trade union movement, as it is understood today, took its birth. Mr. N.M. Lokhande, who was a factory worker in Bombay, is regarded as the founder of the organised labour movement in India.

Factors Which Contributed to Growth

As V.V. Giri observes[4] the following factors helped the growth of trade union movement of India:

(i) *World War I:* Though the labour movement in India began about a century ago, it was only from the end of the First World War (1914-1918) that it gathered momentum. "Both economic and political conditions alike contributed to the new awakening. Prices had shot up during the war and there had been no corresponding increase in the wages, though the employers had amassed fantastic profits. In the political field, new ideas were in the air. The Indian National Congress had formulated its demand for immediate self-government. All this was reflected in considerable labour unrest, one of the features of the twenties. The conditions led, inevitably, to the formation of a large number of trade unions throughout the country."[5]

(ii) *Influence of Political Leaders:* The early stages of the development of trade union movement in India owe a lot to the contributions of some political leaders, social reformers and philanthropists. "The mass movement started by Lokamanya Tilak, Annie

---

[3] V.V. Giri, *op. cit.*, p. 70.

[4] *Ibid.*, p. 4.

[5] *Ibid.*, p. 4.

Besant and later by Mahatma Gandhi caused ripples in the trade union movement. In particular, the non-co-operation movement launched by Gandhiji during 1919-21 and the espousal by him of the cause of the peasants and industrial labour had a profound impact on the working class. Gandhiji was also greatly responsible for giving a re-orientation to the labour movement by establishing the Ahmedabad Textile Labour Association, which had, as its main plank, the setlement of trade disputes by negotiations and peaceful methods before resorting to direct action."[6]

(iii) *The ILO:* The establishment of the International Labour Organisation, of which India was a founder member, prompted the formation of trade unions in India. In choosing its nominees to the International Labour Conference, held annually, the Government had to consult the organisations of the workers and employers to represent their interests. This led to the establishment of the All-India Trade Union Congress as the central body of workers, representing the various trade unions affiliated to it.

(iv) *The Russian Revolution:* The success of the Russian revolution gave an impetus to the labour movement because of the feeling it generated that the solidarity of the working class could achieve great things.

(v) *The Trade Unions Act:* The Indian Trade Unions Act passed in 1926 is a landmark in the history of trade union movement in India because this Act gave trade unions a legal status and immunity to its officers and members against civil and criminal liability for concerted action.

Some Important Developments

As indicated earlier, it was only after the First World War that the trade union movement in India gathered momentum. The widespread labour unrest in the immediate post-war period led to the formation of a number of trade unions in different industries on a permanent basis. In 1920, the All-India Trade Union Congress was established to co-ordinate and guide the activities of the individual unions and to express their views on the general policy matters and programmes affecting labour. As V.V. Giri observes, the foundation of the AITUC marked the first recognition of the common interest of labour throughout the country, and it gave a great fillip to the rapid formation of unions in different parts of the country and in industries, big and small.

In addition to the rights conferred on the registered unions by the Act, their registration enhanced the status of unions in the eyes of the public as well as the employers. In this process, even unregistered unions benefited, and the movement as a whole gained greater confidence of workers.

---

[6] *Ibid.* p. 5.

The conflicts between the moderates and leftists within the All-India Trade Union Congress resulted in a split in the organisation in 1929, with the leftists capturing the congress. The break-away group formed the All-India Trade Union Federation "with a realistic policy, programme and objectives".

The early nineteen thirties were an unfavourable period for the trade union movement. Apart from the serious economic depression which the country had been passing through, Gandhiji's civil disobedience movement, launched in 1930, had diverted the attention of the political leaders of India from the trade union movement. The second split in the All-India Trade Union Congress occurred in 1931, resulting in the formation of a new organisation called the Red Trade Union Congress which, in the next year, united with the parent organisation. The All-India Trade Union Federation and the railway unions joined the National Trade Unions Federation which came into existence in 1933, with a view to forging unity in the trade union movement. The National Trade Union Federation, which claimed a larger membership than the AITUC, and the AITUC merged together in 1938.

Ther period of the Second World War (1939-45) was again a bad time for the trade union movement in India. The unity in the movement that was secured before the war did not last long. Differences arose on the question of the attitude of labour towards the war. The attitude of the communists in the AITUC swung in favour of the Russian involvement in the war. In the early days of the war, the communists were opposed to the war effort of the British Government because the USSR had been in the opposite camp with Germany. A section of labour leaders, who supported the war effort of the British Government, led by the radical democratic leader, M.N. Roy, seceded from the All-India Trade Union Congress and formed a separate central organisation called the Indian Federation of Labour. The Federation, which had the support of the Government, also gained strength and the support of a large number of trade unions. In many industries, rival unions were formed by those who did not subscribe to the view that workers should assist the British in their war effort.

When Hitler and Stalin fell out and the Soviet Union changed over to the side of the Allies, the communists in India changed their attitude too, and, at the behest of the Secretary of the British Communist Party, lent support to the war effort.

The nationalist elements in the All-India Trade Union Congress, however, followed the lead of the Indian National Congress, and most of them were arrested and detained for a long time. Their absence from the trade union field enabled the leaders of the Indian Federation of Labour to strengthen their hold on the workers and the communist leaders to dominate the All-India Trade Union Congress. Even though the official outlook of the AITUC was one of neutrality, there were different groups in it having different views on the war.

Because of the sharp increase in the cost of living and the failure of the employers to appreciate the workers' demands, there was widespread labour unrest. The Government used the Defence of India Rules and prohibited strikes and lock-outs, and referred industrial disputes for conciliation and adjudication. However, the deteriorating economic condition of the workers made the latter conscious of the need for making organised efforts to secure relief. This gave a fillip to the trade union movement, and there was a marked increase, both in the number of unions and of organised workers, by the end of the War. The two central organisations, namely, the All-India Trade Union Congress and the Indian Federation of Labour, actively strove to organise workers in different industries; but the absence of nationalist trade union leaders from the field and the general national outlook of the people operated as a negative factor.

The strained economic conditons following the war and the partition of the country at the time of its independence increased the number of the unemployed and made the plight of the workers very miserable, resulting in widespread labour unrest. There was a feeling on the part of the nationalist-minded trade union leaders, when they came out of jails, that the trade union movement was in a most unorganised manner and that steps should be taken to re-establish the unity which had been noticeable in the thirties. The All-India Trade Union Congress was in the grip of the communists; and the Indian Federation of Labour, because of the patronage it had received from the British, was suspect in the eyes of the people. The Indian National Trade Union Congress (INTUC) was, therefore, started in 1947 under the patronage of the Indian National Congress. In the next year, the Hind Mazdoor Sabha (HMS) was formed by the Praja Socialist Party, and the United Trade Union Congress (UTUC) was formed in the following year by some radicals.

The trade union movement in India after independence has become highly politicalised, so much so that conflicts in the political parties and political alliances and realignments have had their impact on the trade unions as well. Splits in political parties have usually led to splits in the trade unions related to the parties concerned. Thus, for instance, the split in the communist party and the emergence of the Communist Party of India (Marxists) led to a split in the AITUC and the formation of the Centre of Indian Trade Unions (CITU) by the CPI(M). The successive splits in the Indian National Congress and other political parties have had similar effects.

Limitations and Problems of Trade Unionism in India

The trade union movement in India suffers from a number of limitations and problems. Important among them are the following:

(i) *Limited Representation:* Trade unions encompass only a small portion of the total work force of the country. The extent of unionisation is very limited in the unorganised sectors, particularly in agriculture.

(ii) *Small-Size and Increasing Number:* There has been an increase in the number of trade unions. One reason for this increase has been the break-up of the existing unions into two or more fractions. Besides, new small unions have been taking birth. The small size of unions poses problems of weak financial and administrative position, weakening of collective bargaining power, inter-union rivalry, difficulty in establishing employer-employee rapport, etc.

(iii) *Multiplicity of Unions:* The multiplicity of unions has become a very serious problem. As indicated above, the ever-increasing number of unions reduces the average size of the union, so much so that, in many a situation, no single union has an absolute majority support of the workers. Even when a single union can claim majority, the existence of a number of other unions create serious problems for it. The multiplicity of unions weakens the collective bargaining strength of labour. It also makes employer-employee negotiations and the settlement of issues very difficult. The ideal of "one union for one industry" is likely to remain a dream for a very long time to come.

(iv) *Inter-Union and Intra-Union Rivalries:* Inter-union rivalries are a corollary of the multiplicity of unions. Instances of one union trying to beat another union even at the expense of the interests of labour are not uncommon. Inter-union rivalries tend to be intense when the different unions subscribe to different political ideologies, or when they are controlled by mutually opposing political parties. Such rivalries often undermine the effectiveness of collective bargaining and lead to industrial unrest. Sometimes, intra-union rivalries create problems. The personal aspirations of the members, personality conflicts, personal rivalries, etc., are among the causes of intra-union rivalries.

(v) *Political Infiltration:* Politicisation is a serious problem afflicting trade unionism in India. The major trade unions of India—the Indian National Trade Union Congress (INTUC), the All-India Trade Union Congress (AITUC), the Centre of Indian Trade Unions (CITU), the United Trade Union Congress (UTUC), etc. — have political affiliations. Indeed, each political party tries to have its own trade union. As a corollary of this, political rivalries are extended to trade unions. A split in the political parties usually has its impact on the trade unions also. The politicisation of the trade unions many a time leads to a situation wherein the trade unions become tools in the hands of political parties. As V.V. Giri observes: "The introduction of politics into the trade union movement and its domination by leaders of political parties have shattered the unity and strength of the trade union movement in the country. The Indian trade union movement has, therefore, become organisationally weak and, as an institution, it may not be able to effectively promote and protect the interests of the workers, unless and until unions are scientifically managed, placing the genuine economic interests of the workers uppermost in their plan of action."[7]

(vi) *Outside Leadership :* True, in the early stages of the growth of trade unionism in India, outside leadership made very significant contributions. In the past, such leaders were, by and large, dedicated to the cause of labour. But today the situation appears to be different. It seems that, today, for many outside leaders the trade unions are a means to their personal ends. Outside leadership causes a number of problems like inter-union rivalries, misdirection and misuse of trade union movement, etc.

(vii) *Meagre Funds:* Because of the low income of the Indian working class and the small number of members, the funds of the unions are very meagre. Financial constraints come in the way of having full-time officials, organisation and administration, so that strikes might be properly sustained and organised and welfare activities might be conducted for the members and their dependants, etc.

(viii) *Low Income:* The low income of the workers is a negative factor in the growth of trade unions. Because of their low income, workers may feel it difficult to regularly subscribe to the unions. As a result, they may hesitate to join a union. As the Indian worker lives a hand-to-mouth existence, he is not able to strike work for a long time.

(ix) *Illiteracy:* Illiteracy and lack of education of the workers hinder the growth of the trade union movement because workers are often unable to appreciate, and contribute to, the positive role of trade unionism. This also encourages outside leadership. The ignorance and indifference of workers may result in lack of proper control of the leadership and misdirection.

(x) *Lack of Integrity:* Lack of integrity and dedication on the part of trade union leaders is a major drawback of trade unionism in India. Leaders deceiving workers in the negotiations with the employer, misusing their position and funds, using the union for vested interests, etc., are not uncommon. These lead to the disillusionment of workers, so that they may even back out of the union.

---

[7] V.V. Giri, *ibid.*, p. 10.

(xi) *Unhealthy Attitude of Employers:* Many employers in India still regard trade unions as something very bad. There is lack of appreciation of the positive role of trade unions. Many employers are accused of trying to foster disunity among the workers, encouraging inter-union rivalries, disintegrating unions and resorting to unfair practices to weaken trade unionism.

REGULATION OF TRADE UNIONS — THE TRADE UNIONS ACT

Trade unions in India are regulated by the *Indian Trade Unions Act, 1926,* amended from time to time.

The Trade Unions Act has been passed to provide for the registration of trade unions and to define the law relating to registered trade unions. The Act lays down the procedure for the registration of trade unions and their rights and liabilities.

Registration of Unions

Any seven or more members of a trade union may, by subscribing their names to the rules of the trade union and otherwise complying with the provisions of this Act with respect to registration, apply for the registration of the trade union under this Act.

Every applicaton for the registration of a trade union shall be made to the Registrar, and shall be accompanied by a copy of the rules of the trade union, and provide all other particulars required by the Act.

The Act lays down that the following Acts, namely:

The Societies Registration Act 1960; The Co-operative Societies Act, 1912; and The Companies Act, 1956, shall not apply to any registered trade union, and that the registration of any such trade union under any such Act shall be void.

Rights and Liabilities of Registered Unions

The Act lays down the rights and liabilities of registered trade unions. Some of the important rights and liabilities of the registered unions are:

(i) The general funds of a registered union shall not be spent on any other objects than those specified in the Act.

A registered union may constitute a separate fund from contributions separately levied for or made to that fund, from which payments may be made for the promotion of the civil and political interests of its members, in furtherance of any of the objects specified in the Act.

(ii) No office-bearer or member of a registered trade union shall be liable to punishment under sub-section (2) of Section 120-B of the Indian Penal Code in respect of any agreement made between the members for the purpose of furthering any such object of the trade union as is specified in Section 15, unless the agreement is an agreement to commit an offence.

(iii) No suit or other legal proceeding shall be maintainable in any civil court against any registered trade union or any office-bearer or member thereof in respect of any act done in contemplation or furtherance of a trade dispute to which a member of the trade union is a party on the ground only that such an Act induces some other person to break a contract of employment, or that it is interference with the trade, business or employment of some other person or with the right of some other person to dispose of his capital or of his labour as he wills.

Further, a registered trade union shall not be liable in any suit or other legal proceeding in any civil court in respect of any tortious act done in contemplation or furtherance of a trade dispute by an agent of the trade union, if it is proved that such person acted without the knowledge of, or contrary to express instructions given by, the executive of the trade union.

(iv) The account books of a registered trade union and the list of members thereof shall be open to inspection by an office-bearer or member of the trade union at such times as may be provided for in the rules of the trade union.

(v) A person shall be disqualified for being chosen as, and for being a member of, the executive or any other office-bearer of a registered trade union if:

(a) He has not attained the age of eighteen years;

(b) He has been convicted by a court in India of any offence involving moral turpitude and sentenced to imprisonment, unless a period of five years has elapsed since his release.

(vi) Not less than one-half of the total number of office-bearers of every registered trade union shall be persons actually engaged or employed in an industry with which the trade union is connected.

However, the appropriate Government may, by a special or general order, declare that the provisions of this section shall not apply to any trade union or class of trade unions specified in the order.

(vii) Any registered trade union may, with the consent of not less than two-thirds of the total number of its members and subject to the provisions of Section 25, change its name.

(viii) Any two or more registered trade unions may become amalgamated together as one trade union with or without the dissolution or division of the funds of such trade unions or either or any of them, provided that the votes of at least one-half of the members of each or every such trade union entitled to vote are recorded, and that at least sixty per cent of the votes recorded are in favour of the proposal.

(ix) When a registered trade union is dissolved, notice of the dissolution signed by seven members and by the secretary of the trade union shall, within fourteen days of dissolution, be sent to the Registrar, and shall be registered by him if he is satisified that the dissolution has been effected in accordance with the rules of the trade union, and the dissolution shall have effect from the date of such registration.

Where the dissolution of a registered trade union has been registered and where its rules do not provide for the distribution of the funds of the union on dissolution, the Registrar shall divide the funds among the members in such manner as may be prescribed.

(x) A registered trade union shall send a properly audited annual statement of all receipts and expenditure in the prescribed form within the prescribed time. Along with this, a statement showing all the changes in the office-bearers made by the union during the year and a copy of the rules of the union corrected up to the date of despatch should also be sent.

(xi) A copy of every alteration made in the rules of a registered trade union shall be sent to the Registrar within fifteen days of the making of the alteration.

(xii) For the purpose of examining the documents of a registered union, as specified in the Act, the Registrar, or any officer authorised by him, may, at any reasonable time, inspect the certificate of registration, account books, registers and other documents relating to the trade union at its registered office or may require their production at such place as he may specify in this behalf; but no such place shall be at a distance of more than ten miles from the registered office of the trade union.

32

Exit Policy

With the new economic policy which would pave way for economic restructuring, *Exit Policy* has become a widely debated subject in India.

Need for Exit Policy

Exit policy refers to the policy regarding the retrenchment of the surplus manpower resulting from restructuring of industrial units or the workers becoming unemployed by the closure of sick units. The exit policy in its wider context covers the policy for the compensation for the employees who leave the organisation and the measures for their rehabilitation also.

Surplus manpower is a major problem of many industrial units in India. The Industrial sector too is characterised by *disguised unemployment*.* This problem is very rampant in the public sector. The private sector also suffers from this problem.

In the seller's market which existed in India under the protected economic system, the high costs of surplus manpower employed by the companies could be passed on to the consumers by way of high prices. However, survival in a competitive system demands cost efficiency improvement and cost reduction in every possible way. It may become necessary not only to get rid of the surplus manpower under the existing technology but also to cut the labour force size further due to modernisation. In some cases, it may also become necessary to give up some of the existing lines of business to maintain or improve the health of the enterprise. Thus, some of the measures which industrial undertakings take to improve the competitiveness and to ensure survival, would render a part of the existing manpower unemployed. If the enterprises do not take such measures in time, it may even ultimately lead to the closure of the units throwing all the workers unemployed.

---

* There is disguised unemployment if some labour employed in an enterprise can be withdrawn without adversely affecting the production. This concept was originally used to describe the situation which exists in the agricultural sector of the developing countries.

There are also a large number of unviable sick units, both in the public and private sectors. There is no economic and social justification for their continuation. Those who argue that the State should run the sick units fail to recognise the fact that the society will have to bear the cost of the huge losses these units make and that amount could be invested elsewhere for generation of productive employment or for enhancing the social welfare.

If the required restructuring to improve competitiveness and the closure of unviable sick units are not allowed, the whole economy would become sick in due course. There is, therefore, no options.

The new economic policy may create unemployment at the enterprise level in a large number of cases. It does not, however, mean that NEP would increase the total unemployment in the economy. Contrary to that, it would help increase the total employment. In fact, a deviation from the old policy was a must even to maintain the existing level of employment in the long run.

Technology is becoming more and more labour saving. Technological developments are making several industries which in the past were labour intensive more and more capital intensive. Countries which do not adapt themselves to the changing environment would ultimately see their employment shrinking.

Technological developments which increase productive efficiency are affecting employment in many organisations over the world. The multinational giant IBM which has assiduously followed a cardinal philosophy of non-retrenchment for a very long time now has recently been compelled to give up this policy. Modernisaton or restructuring may lead to job cuts at the enterprise level. But will this mean a fall in total employment or only a change in the pattern of employment generation? The evidence from other countries suggests the latter. Had this not been so, the level of unemployment would have been highest in Japan where the rate of technological change is the swiftest. Instead, it is the lowest, with Germany only a step behind.

One of the major failures of Indian system has been the inability to recognise the implications of technological developments. The unpragmatic employment protection policies have created many long term problems. "Experience the world over suggests that modernisation can work only if labour is trimmed sharply. Modern looms need only one-fifth the labour that obsolete ones do. If a company cannot shed labour, modernisation will saddle it with both high capital costs and high labour costs, a recipe for bankruptcy. Indeed, the inability of the Indian firms to tailor their workforce to the level of capital employed has been an important reason why firms have not modernised. This rigidity in the labour market has also meant that the Indian labour, contrary to popular belief, is not at all cheap. The Japanese have pointed this out often, saying that while it may be cheap in the first round of investment, thereafter it becomes expensive because swift capital-labour adjustment are just not possible."[1]

It is high time that India corrected the growth defeating policy of protecting the existing jobs at high social costs. Employment generation by the industrial sector depends, *inter alia,* on the dynamism of the industrial sector.

Extent of Overmanning

A large member of the people employed in the industrial and other sectors of India is surplus. However, there is no reasonably accurate estimate of the extent of the surplus of the manpower employed.

The overmanning has two dimensions, viz., the surplus even with the existing technology employed by the enterprises and the surplus that will emerge if the existing technology is replaced by modern technology.

In many cases, the Indian industry uses more labour than those in other countries even when the technology used is the same. For example, the Aditya Birla group uses the same textile machinery in India that it does in its other plants in Southeast Asia. But it takes just two workers to process 100 Kg. of yarn in Indonesia and three in Philippines and Thailand; in India, Birla's Grasim Industries needs seven people for the same job. Against a labour cost of Rs. 50 to process 100 Kg. of yarn in Indonesia, the wage bill in India is 14 times more: Rs. 700.*

Use of obsolete technology causes very high labour costs. For example, if the textile industry uses modern technology, about 15 million employees in this industry would be rendered excess. The use of obsolete technology makes cost of production very high in India. For instance, while it takes a South Korean worker 11 hours to make a tonne of steel, his counterpart in TISCO would take two days. With vintage factories, some of which are more than 75 years old, ACC produces 475 tonnes of cement per worker while Gujarat Ambuja produces 2000 tonnes per head.

By estimating the number of workers in sick public and private sector units, Sudipto Mundle arrived at a figure of 2.4 million surplus manpower in the industrial sector. Assuming the same level of redundancy in government employment (18 per cent) Mundle has assumed for estimating the surplus in public sector companies. *Business Today* has estimated that 1.8 million of the total of over 10 million government staff, including administrative staff and workers in departmental undertakings (like railways, telecom, etc.) is excess.

---

* The statistics quoted in this subsection and in the next are from Neeraj Kaushal and Shekhar Gosh, "Axing 4 million Jobs" and Shekhar Gosh, "Painless Fairwell", *Business Today,* April 22-May 6, 1993.

According to Pramod Verma, even without technological change, it should be possible to reduce labour by five to seven per cent which means between 13 and 18 lakh people and if technology is upgraded, the organised sector would lose another 25 lakh jobs.

A study by the Textile Ministry had estimated that there were 80,000 surplus workers in the National Textile Corporation (44 per cent of total employment). There is a surplus of about 50,000 workers in Coal India and this figure could be much higher once the technology for underground mining is upgraded. Besides, the Singareni Collieries, which has already been referred to the BIFR, has about one lakh workers.

A study by Mrityunjaya Athreya, conducted in 1987, revealed that the Steel Authority of India (SAIL) had a surplus of 80,000 workers.

At least 50 per cent of the workers of the State road transport undertakings, which have accumulated losses well in excess of Rs. 3,500 crore, is surplus. The same may be true of state electricity boards which have over nine lakh people on their pay rolls.

The figures given above give some indication of the extent of the exorbitant overmanning of the Indian economy.

VRS and Golden Handshake

It is necessary to dispense with the excess manpower for improving the health of an organisation. If this is not done, the excess labour could cause industrial sickness.

A popular method to trim the manpower is the *voluntary retirement scheme* (VRS). Under the VRS, employees who have attained forty years of age or ten years of service would seek voluntary retirement. The minimum benefits under this scheme would be forty five days emoluments for each completed year of service or the monthly emoluments at the time of retirement multiplied by remaining months of service before normal date of retirement whichever is less. The benefits would be in addition to the money that have accrued to the Provident Fund as per the rules or to the Gratuity Fund whichever is applicable.

Some companies offer very attractive package of benefits to the employees who would opt for VRS. Such schemes are often referred to as *golden handshake* scheme. While the golden handshake scheme offered by some companies in the past worked every well, the offers made by some companies recently failed to elicit the required response from the workers. An important reason for this is said to be the higher expectations workers began to entertain as the concept of golden handshake has became popular.

One possible drawback of the VRS is that the efficient employees would leave the company while the inefficient may stay back; the efficient ones would be hopeful for alternatives outside while the inefficient may not be very optimistic.

A number of companies have already reduced their workforce by VRS. These VRSs have taken different forms. In fact, the process of getting rid of the excess labour started in several companies much before the economic reforms ushered in India.

The ACC has brought down its workforce from 25,000 to 16,000 in 10 years. Between 1987 and early 1993, SAIL got rid of 17,000 workers through its VRS and by the end of the century another 57,000 would retire. Premier Automobiles has planned to chop 3000 jobs; some 1600 have already left. There are also several other such cases.

The VRS takes different forms while in SRF Ltd. the VRS cost was a low Rs.25000 to one lakh per head, in Hindustan Geigy it was about Rs. 4.4 lakh per head on an average. The absolute limit set by the government is Rs. 5 lakh.

The NTC has offered looms at subsidised rates to the workers under the VRS package. They are also offered sheds for housing the looms and marketing facilities to sell their production. Between November 1992 and March 1993, 25,000 NTC workers have accepted VRS. Road transport firms can offer buses to the employees under the VRS.

NRF

A very important step taken by the Central Government to benefit the workers affected by industrial restructuring, modernisation or closure of the unit was the establishment of the National Renewal Fund which was operationalised in 1992.

The objectives of the NRF are the following:

(i) To provide assistance to firms to cover the cost of retraining and redeployment of employees arising as a result of modernisation and technological upgradation of existing capacities and from industrial restructuring.

(ii) To provide funds for compensation to employees affected by restructuring or closure of industrial units, both in the public and private sectors.

(iii) To provide funds for employment generation schemes in the organised and unorganised sectors in order to provide social safety net for labour.

The NRF is administered by the Department of Industrial Development. The first set of cases taken up by the Department were those relating to the National Textile Corporation.

The NRF was proposed to have a corpus of Rs. 2,000 crores which would be contributed by three sources: Rs.200 crores as budgetary support (the 1991-92 earmarked this amount); Rs.1,000 crores from the disinvestment of public sector undertakings' shares and Rs. 800 crores from the World Bank.

The NRF was proposed to have tow parts. The first part is the Employment Generation Fund, which would provide resources to approved employment schemes in the organised and unorganised sectors. The second part is the National Renewal Grant Fund to meet the compensation and training expenditures of retrenched workers.

Conclusions

Although a full-fledged, detailed exit policy has not yet been formulated, the establishment of the National Renewal Fund is very important step. This is indeed a clear indication of the appreciation of the need for modernisation, restructuring and even closure of units in inevitable cases and that if these measures render workers unemployed the right policy is not to resist such measures but to retrain and redeploy the workers to the extent possible.

Schemes like NRF should not be made completely dependent on the national exchequer. A scheme for regular contribution to such a fund by the companies and workers should be designed and implemented.

As mentioned earlier many companies and organisations all over the world, one time or the other, have faced the problem of surplus manpower. It was reported that the Chinese Government had decided to bring about sweeping changes in the Central Government structure causing a 20 per cent cut in the number of government employees. India cannot afford to be blind towards hard realities. Organisations should be allowed and facilitated to swiftly respond to environmental realities to enable them to become efficient and competitive.

The workers have a lot of apprehension about the very term exit policy. One of the important objectives of an exit policy is to protect the interests of the workers. However, instead of educating the workers about it, the trade unions and politicians seem to be causing unnecessary fears in the minds of the workers. It is pointed out that "the exit policy on which the union bosses are currently declaiming pertains to their own impending exit and not that of the common worker.

It is almost a certainty that the average retrenched blue-collared person will get a fair deal by way of compensation, retraining and redeployment."[2]

In fact, the biggest loser of not having an exit policy is the labour because the legitimate interests of labour are protected only when there is a legal closure of a sick mill. In a situation of a silk unit not functioning and not legally closed, workers may remain years together without employment wages and not getting their legitimate dues. One may therefore argue that "if properly implemented, it is the most pro-labour policy imaginable."[3]

---

[2] Editorial, "Clinging to Power", *Business World*, 1-14 July 1992, p. 8.

There is however, a growing realisation among the workers of the need to increase productivity to survive the domestic and foreign competition; if firms do not shed the excess manpower all the workers would sink with the firm. While in some companies the unions cooperate with the VRS, in several companies they have strongly opposed. In a number of cases the workers defied the call of the unions to boycott the VRS.

The response of the workers to the VRS may depend upon the attractiveness of the scheme, their assessment of the future of the enterprise etc. In 1989, when the Hindustan Lever lifted its year long lock-out at its Sewree plant in Bombay, more than 550 workers availed of the VRS. But in 1992 when the HLL offered another Scheme to retire 500 workers, only nine of them accepted it.

An amount of Rs. 542.23 crores was released from the NRF in 1993-94 and an estimated 75000 workers opted for VRS under the scheme. A major part of the funds was used in the textiles sector.

---

3. **N. Chandramohan and Ruchira Gupta, "Exit is not a four letter word", *Business India*, Mach 2-15, 1992, p. 51.**

33

Planning in India

The pattern of economic development in India is very significantly affected by Government planning. The direction of the development pattern of the various sectors and the relative priorities within each sector are determined by the Five Year Plans. The scope and prospects of different industries and other businesses, therefore, depend, to a very large extent, on the development planning. It may be noted that even the development plans for the agricultural sector have a number of implications for the industrial and commercial sectors. For example, plans to boost agricultural production may increase the demand for agricultural machinery like pumpsets; inputs like fertilizers, pesticides and better seeds; materials like cement and steel (to build up irrigation systems etc.) and so on. The increase in the agricultural income in turn would increase the demand for the output of the consumer goods industries, other industries and services.

A lot of information needed for business decision-making like investment decision-making can be obtained by analysing the development plans like the Five Year Plans.

THE PLANNING MACHINERY

The Planning Commission

The Planning Commission was set up in March 1950, by a Resolution of the Government of India, with the following functions.

(i) To make an assessment of the material, capital and human resources of the country, including technical personnel, and investigate the possibilities of augmenting such of these resources as are found to be deficient in relation to the nation's requirements;

(ii) To formulate a plan for the most effective and balanced utilisation of the country's resources;

(iii) On a determination of priorities, to define the stages in which the plan should be carried out and propose the allocation of resources for the due completion of each stage;

(iv) To indicate the factors which tend to retard economic development, and determine the conditions which, in view of the current social and political situation, should be establilshed for the successful execution of the plan;

(v) To determine the nature of the machinery which will be necessary for securing the successful implementation of each stage of the plan in all its aspects;

(vi) To appraise from time to time the progress achieved in the execution of each stage of the plan and recommend adjustments in policy and measures that such appraisal may show to be necessary; and

(vii) To make such interim or ancillary recommendations as appear to it to be appropriate either for facilitating the discharge of the duties assigned to it, or on a consideration of the prevailing economic conditions, current policies, measures and development programmes, or on an examination of such specific problems as may be referred to it for advice by Central or State Governments.

From the beginning, the Prime Minister has been the Chairman of the Planning Commission. It has a Deputy Chairman and full-time members who include eminent economists and experts in various fields. At times the Deputy Chairman is also the Minister for Planning, who may be assisted by a Minister of State for Planning. From an early stage, the Minister of Finance has been a member of the Commission. As regards the members of the Commission, the Administrative Reforms Committee's Study Team on Planning Machinery had suggested that "the members should be chosen for their expertise, wisdom and knowledge of handling men and affairs, and what we need is not narrow specialisation, but wide knowledge and experience in major areas of development, such as agriculture and rural economy... The persons chosen should enjoy a reputation in the country as a whole for their wisdom, impartiality, integrity, and objectivity." For administrative purposes, the Commission has a Secretary who is assisted by a Joint Secretary and a Deputy Secretary.

With a view to ensuring that investment decisions on the projects to be included in the Plan are taken after a thorough examination of project estimates and a consideration of the other alternatives that are available, a *Project Appraisal Division* has been set up in the Planning Commission, whose main functions are:

(i) To suggest standard formats for the submission of projects and procedures for their techno-economic evaluaton;

(ii) To conduct an actual techno-economic evaluation on the strength of the cost-benefit analysis of selected major projects and programmes suggested to the Planning Commission;

(iii) To assist State Governments and Central Ministries in giving effect to standardised formats and procedures for project evaluation;

(iv) To undertake and support research leading to a progressive refinement of the methodology and procedures of project evaluation; and

(v) To make an economic appraisal of projects which come up for Government sanction.

There is also a *Programme Evaluation Organisation* attached to the Planning Commission. Its main functions are :

(i) To study the progress of the programme and to measure its impact on the socio-economic life of the rural people;

(ii) To ascertain the reasons for the success or failure of different items of the programme; and

(iii) To indicate the direction in which imporvements may be sought.

The Programme Evaluation Organisation has a number of evaluation units in different parts of the country and is increasingly devoting itself to studies and investigations bearing on specific problems.

The Planning Commission functions with a series of Divisions and Sections, each headed by a senior officer designated usually as Adviser or Chief or Joint Secretary (depending partly upon the particular official's position in the general structure). A few of the Divisions are headed by middle grade officers, known as Directors, who work generally in association with other senior officials. The full-time members of the Planning Commission assume responsibility for the day-to-day work of particular Divisions or Sections, although the Commission functions as a body and tenders advice jointly on all important policy matters. The various Divisions may be divided broadly into two categories:

(a) *General Divisions*, which are concerend with certain special aspects of the entire economy; and

(b) *Subject Divisions*, which are concerned with specified fields of development.

The Planning Commission has a Division for Perspective Planning, which is expected to provide general guidance for work on long-term development undertaken in detail in different Divisions. Co-ordination of work and operations within the Planning Commission is undertaken by a Plan Co-ordination Section.

The NDC

A number of Committees and Commissions are also working under or associated with the Planning Commission. One of the most important among them is the *National Development Council* (NDC). The NDC is presided over by the Prime Minister and is composed of Union Cabinet Ministers, Chief Ministers of States and Union Territories (The Union Territory of Delhi is represented by the Lt. Governor and Chief Executive Councillor), and Members of the Planning Commission. The other Union and State Ministers may also be invited to participate in the deliberations of the Council. The Secretary of the Planning Commission acts as Secretary of the NDC, and the Commission is expected to provide such administrative and other support as may be necessary. The main functions of the NDC are:

(i) To prescribe guidelines for the formulation of the National Plan, including the assessment of the resources for the plan;

(ii) To consider the National Plan as formulated by the Planning Commission;

(iii) To consider important questions of social and economic policy affecting national development; and

(iv) To review the working of the plan from time to time and to recommend such measures as are necessary for achieving the aims and targets set out in the National Plan, including measures to secure the active participation and co-operation of the people, improve the efficiency of the administrative services, ensure the fullest development of the less advanced regions and sections of the community, and through sacrifice borne equally by all the citizens, build up resources for national development.

From the functions mentioned above, it is quite obvious that the NDC has a decisive role in the formulation and follow up of the execution of the National Plan. Its role signifies the federal and democratic nature of the Indian planning.

STATE PLANS

State Plans account for about one-half of the total outlay of the Government under a Five-Year Plan. The subjects that come under State jurisdiction include such vital sectors of development as agriculture, small industries, irrigation and power, roads and road transport, and education and social services.

A successful implementation of major national policy objectives calls for an organisation at the State level which can co-ordinate effectively and provide guidance to local democratic bodies, and take a wider view of development than is generally possible for individual departments. The States have Planning Boards and Departments which co-ordinate the work of other departments for the preparation of development plans, and present reports on the execution of State Plans. State Planning generally receives directions from a committee of the State cabinet and is supported by the State Statistical Bureau.

FORMULATION OF THE PLAN*

The preparation of a Five-Year Plan is usually spread over a period of two to three years. The first stage is the consideration of the general approach to the formulation, involving an examination of the state of the economy, an appraisal of past trends in production, and the rate of growth in relation to the long-term view of the economy. Preliminary conclusions on these and related matters are submitted by the Commission to the Central Cabinet and to the National Development Council. On their approval, these are published in the form of a document and circulated widely for country-wide debate.

The second stage consists of studies which are intended to lead to a consideration of the physical content of the plan. While these studies proceed, the Planning Commission constitutes groups for each sector, composed of its own specialisits and those of Ministries and non-official experts, which review the situation in their respective fields and make the assumptions to be made in the formulation of the plan, and indicate the targets of production to be achieved.

While preliminary documents are being debated throughout the country, the Commission holds detailed discussions with the Union Ministers, State Governments and Union Territories at the highest level. The Consultative Committee of Members of Parliament on Planning keeps in close touch with plan formulation constantly by periodic meetings and informal discussions.

On the basis of the preliminary studies undertaken by the groups and discussions with the various interests, the Commission presents the main features of the plan under formulation in the form of a draft plan, which is discussed in detail by the Cabinet and is placed again before the National Development Council. With the approval of the Council, the Draft Plan is published for public consideration and country-wide debate.

The comments and suggestions on the Draft Plan offered by Members of Parliament and people from different walks of life are taken into consideration in the preparation of the final document of the plan. This document, prepared by the Planning Commission, outlines the objectives, policies and programmes of the plan. It is once again submitted to the Cabinet and the National Development Council.

---

* Adopted from "How A Plan is Formulated," *Yojana*, 15th August, 1980, p.45.

With such modifications as the National Development Council might suggest, the document is presented to Parliament for final approval.

REVIEW OF THE PLANS

The era of planned development dawned in India with the launching of the First Five-Year Plan on April 1, 1951. The process of implementation of Five-Year Plans was, however, interrupted in 1966, after the completion of the Third Five-Year Plan by the end of March 1966. The Fourth Plan, which should have, in normal course, commenced in April 1966 did not get off on schedule due to some problems during the Third Plan which seriously disrupted the development process, like the aggressions by China and Pakistan and the severe drought in the country, particularly in the last year of the Third Plan, 1965-66, (and also the year that followed) resulting in fall income, sharp rise in prices and fall in savings; serious balance of payments problems which led to the devaluation of the Rupee by 36.5 per cent in June 1966 etc.

The Fourth Five-Year Plan was put off by three years. The interventing period between the Third and the Fourth Plans (i.e., 1966-67 to 1968-69) had *Annual Plans*. This period is referred to by some people as *Plan Holiday.*

The political change at the Centre led to a premature end to the Fifth Five-Year Plan. The *Janatha* Government which assumed power in 1977 terminated the Fifth Plan at the end of the fourth year, i.e., in March 1978 instead of March 1979 and formulated a *Draft Five Year Plan* for 1978-83.

The *Janatha* Government also introduced the *Rolling Plan*. Under the rolling plan,when one year elapses another year is added to the planning horizon so that we will always have a 'Five-Year Plan'. The main advantage claimed for the rolling plan is that plan performance can be reviewed and targets revised on the basis of the changing situation. However, the success of rolling plan in a country like India is constrained by the non-availability of uptodate data needed for such revisions.

The fall of the *Janatha* Government also led to the end of the Five-Year Plan formulated by them. The *Congress* Government which came to power in1980 terminated the Five-Year Plan formulated by the previous government at the end of its second year and formulated a Five-Year Plan for 1980-85 (the *Sixth Plan*). On the completion of the Sixth Plan, the Seventh Five Year Plan was launched in April 1985.

The main objectives of the Indian plans have been:

(i) Alleviation and ultimate removal of unemployment and poverty.

(ii) Improvements in the standard of living.

(iii) Optimum utilisation of the national resources.

The avowed objectives of planning like rapid increase in income, generation of employment, social or redistributive justice, self-reliance etc.

are obviously means to achieve the objectives or aspects of the objectives mentioned above.

There have been changes in the priorities of development and emphasis on objectives through the plans. For example, the development priority shifted from agriculture in the First Plan to basic and heavy industries in the Second Plan. The Third Plan recognised the importance of export promotion and the Fourth Plan emphasised self-reliance as an objective of development. 'Growth with Social Justice' has been receiving added emphasis since the Fifth Plan. The Fifth Plan, which realised that 'a direct attack on poverty' was necessary for rapid eradication of poverty, formulated a specific package of programmes, known as the *minimum needs programme*, to improve the living conditions of the poor and these programmes have been continued, with modifications, in the subsequent plans. A significant step-up in the rate of growth of the economy, strengthening the redistributive bias of the public policies and services in favour of the poor were among the major objectives of the Sixth Plan. The focus of the Seventh Plan is on food, work and productivity.

Performance

Although the Plans have mostly failed to achieve the targets and shortfalls are conspicuous in several areas, India has made, undoubtedly, very significant progress. With about 30 per cent of the population still below the poverty line, India is one of the largest industrial powers in the world and has the third largest stock of scientific manpower.

When compared to the modest targets, the performance of the First Plan was satisfactory. Though the industrial sector failed to grow upto the targets, the Sixth Plan could achieve the overall growth target because of the better performance of the agricultural and service sectors. Performance of all other plans was rather unsatisfactory, judged by the achievement of the growth targets.

The long-term average annual growth rate of the economy was only about 3.5 per cent and of the per capita income about 1.5 per cent. There has, however, been an acceleration of the growth rates since the Sixth Plan.

It is common to criticise the Indian planning for its failures, pointing out the magnitude of poverty, unemployment, housing problem etc. prevailing today despite nearly four decades of planning. According to the estimates of the Planning Commission, even at the end of the Seventh Plan (March 1990) about 211 million people would still be below the poverty line. The total population of only a few countries like China, the USSR and the USA is more than the size of the Indian population below the poverty line. Similarly, the number of people unemployed in India is larger than the labour force of many countries; the number of households in India without satisfactory housing is larger than the total number of households in most countries. In fact, the number being added to the Indian population during the decade of 1980s is larger than the total population in most of the countries. All these highlight the gigantic task facing a poor nation. It is, therefore, not right to view the prevalence of certain problems of large magnitude only as a reflection of the failure of the planning; they should also be viewed as alarming problems of the magnitude which no other country in the world, except perhaps China, faces. To solve the basic problems, the additional employment to be created, the additional houses to be built, the additional number of children to be educated, the additional number of people to be provided with medical facilities and so on during one Five-Year Plan in India are more than what most nations have had done over centuries. Yes, that is the magnitude of the development challenges India is facing!

Despite many odds, significant progress was made in almost all important spheres. Between the beginning of the First Plan (1951) and the end of the Seventh Plan (1990), the gross domestic product (GDP) at 1980-81 constant prices increased 3.6 times, per capita income nearly doubled, index of agricultural output doubled, index of industrial production registered a ten fold increase, production of coal increased nearly seven fold, output of crude oil rose from 0.26 million to over 34 million tonnes, electricity generation went up from 5.3 billion kwh to over 245 billion kwh and domestic savings increased from about 10 per cent of the GDP to 22 per cent. During the same period, the number of hospital beds per 10,000 population increased from 3.2 to 9.4, the average life expectancy at birth increased from 32 years to about 59 years and the literacy rate improved from less than 17 per cent to nearly 52 per cent.

Of course, it would have been possible to achieve better results with better planning, more efficient implementation of the programmes and pragmatic policies.

In the Foreword to the Seventh Five-Year Plan, Prime Minister Rajiv Gandhi observed: "Planning has given us a strong base for building a modern, self-reliant industrial economy. Indian industry today is highly diversified, producing a wide range of products, many embodying a high level of technology. The public sector has a commanding presence and has played a pioneering role in many areas. We have a broad entrepreneurial base and ample technological and managerial manpower. But some weakness have also become evident. Much of our industry suffers from high cost. There is inadequate attention to quality. In many areas we are working with technology that is obsolete. We have reached a watershed in our industrial development, and in the next phase we must focus on overcoming these problems. Our emphasis must be on greater efficiency, reduction of cost and improvement of quality. This calls for absorption of new technology, greater attention to economies of scale and greater competitions." It may be noted that efforts are being made in these directions.

EIGHTH FIVE YEAR PLAN

The National Development Council (NDC) approved the objectives and the document on Thrusts and Macro Economic Dimensions of the Eighth Five Year Plan in December 1991. The Plan which commenced on April 1, 1992, gives priority to the following objectives:

(i) Generating adequate employment to achieve near full employment by the turn of the century;

(ii) Containing population growth through people's active co-operation and an effective scheme of incentives and disincentives;

(iii) Universalisation of elementary education and complete eradication of illiteracy among people in the age group 15 to 35 years;

(iv) Provision of save drinking water and primary health care accessible to all villages and entire population and complete elimination of scavenging;

(v) Growth and diversification of agriculture to achieve self-sufficiency in food and generate surplus for exports; and

(vi) Strengthening of infratructure (energy, transport, communication, irrigation) in order to support growth process on a sustainable basis.

The Eighth Plan will focus on these objectives keeping in view the need for (a) continued reliance on domestic resources for financing investment (b) increasing technical capabilities for the development of science and technology, and (c) modernisation and competitive efficiency so that the Indian economy can keep pace with and take advantage of global developments.

Human resource development will be the main focus of the Eighth Plan. It is towards this ultimate goal that employment generation, population control, literacy, education, health, drinking water and provision of adequate food and basic infrastructure are considered as the priorities of the plan. Provision of the basic elements which help development of human capital will remain the primary responsibility of the Government.

The Eighth Plan aims at an average growth of 5.6 per cent per annum and Incremental Capital-output Ratio (ICOR) is assumed to remain more or less at the same level as in the Seventh Plan (4.1). For achieving the targeted growth, the average rate of domestic savings required during the Eighth Plan will be 21.6 per cent GDP. The corresponding investment rate will be 23 per cent of GDP. A total investment of Rs. 7,92,000 crore at 1991-92 prices is evisaged for the Eighth out of which the share of public sector investment will amount to Rs. 3,42,000 crores or 43.2 per cent of the total investment as compared with 45.7 per cent realised in the Seventh Plan. This allows a larger scope for the private sector than that given hitherto. Public Sector outlay is Rs. 4,00,000 crore inclusive of the current outlay component. The plan envisages a perceptible change in the manner of financing practised so far, which was neither envisaged nor healthy for the economy. Draft on foreign savings is estimated at 1.4 per cent of GDP amounting to Rs. 49,000 crores. The public sector investment will be financed to the extent of 70 per cent from household savings, 20 per cent from own savings and 10 per cent from the rest of the world. Determined efforts are called for on the part of the Central and State Governments and their enterprises to make their respective contributions to savings, so that the projected public sector outlay of Rs. 4,00,000 crores is realised.

It is also considered necessary to reorient the process of planning so as to:

(a) weed out projects which are not economically sound;
(b) rationalise plan expenditure by a process of consolidation and coordination of schemes;
(c) generate net additional resources to the extent possible through non-inflationary measures, particularly in the sectors which claim higher outlays; and
(d) divert some funds from the sectors which have surpluses largely due to the Government policies (administered prices), to the needy sectors, which cannot raise resources out of their own activities.

TABLE 34.1

Macro Aggregates for the Eighth Plan (1992-97)

(Rs. crores at 1991-92 prices)

	1991-92	*1996-97 (Target)*	*Total 8th Plan*
(1)	*(2)*	*(3)*	*(4)*
GDP at Factor Cost	519716	682473	3069138
GDP at Market Prices	582356	764730	3439053
Gross Domestic Savings	125789	165182	742835
Private Consumption	389211	504000	2266530
Gross Domestic Capital Formation	140348	172295	797698
Foreign Savings @	14559	7113	54863
Exports of Goods*	44292	83869	330153
Exports of Goods & Non-Factor Services*	55762	102366	407342
Imports of Goods*	62345	93314	399650
Imports of Goods & Non-Factor Services*	72848	112797	477128

Note: Foreign trade figures for 1991-92 are estimated as normalised base for projections during the Eighth Plan.

@ The abnormally low imports in 1991-92 compared to 1990-91 resulted in lower foreign savings than the normal base which is shown here. Preliminary RBI data indicates foreign savings of Rs. 9,000 crores, but the national accounts data is not yet available for the year.

* Exports and Imports projections for 1991-92 are the normalised proejections, since the actuals are expected to be exceptionally low in this year.

TABLE 34.2

Macro-Parameters for the Eighth Plan (1992-97)

Rates/Ratios	*Seventh Plan (1985-90)*	*Seven Years Including Seventh Plan (1985-92)*	*Eighth Plan (1992-97)*
(1)	*(2)*	*(3)*	*(4)*
Rate of Growth in GDP (per cent per annum)	5.8	5.3	5.6
Domestic Saving (per cent of GDP)	20.4	20.7	21.6
Investment (per cent of GDP)	22.7	23.0	23.2
Current Account Deficit (per cent of GDP) @	2.4	2.4	1.6
ICOR	3.9	4.3	4.1
Growth Rate in: Exports of Goods (% per annum)	8.1†	8.5*	13.6
Imports of Goods (% per annum)	10.0	7.5*	8.4

@ In the Seventh Plan, the interest paid on NRI deposits was not included as part of Current Account Deficit (CAD) since RBI released the NRI capital inflow data after accounting for the interest paid. The CAD projection for Eighth Plan includes the interest paid on NRI deposits, as an item of import of non factor services. Current Account Deficit and the rate of domestic saving do not exactly add up to rate of investment in this Table because of rounding up errors.

† This is estimated on the bais of National Accounts Statistics for five years of the Seventh Plan period. As per D.G.C.I. & S. quantum index, the estimates are 7.6 per cent for plan period and 11.6 per cent during the last four years of the Seventh Plan.

* These represent only six years average since the year 1991-92 has been an abnormal year in respect of foreign trade.

Sectoral Pattern of Investment

Gross investment during the Eighth Plan distributed according to broad sectors of economic activity is presented in Table 8. Agrriculture, Irrigation and allied sectors will account for 18.65 per cent of total investment. Mining and Manufacturing will get 28.57 per cent; Electricity, Transport and Communication will take 26.54 per cent of the total and the remaining investment will be in the construction and services sectors. The sectoral investment in the five year period (1992-97) include the requirements for sustaining the growth in output in the post-plan period.

Distribution of Investment between public and private sectors at the sectoral level is based on the proposed reorientation in the relative roles of the private and the public sector objectives. The broad industrial groups where private sector is expected to have a much larger share than hithero are electricity, communications, mining and quarrying particularly oil and coal, large industries in manufacturing sector (petro-chemicals, metals, fertilisers and heavy capital goods) and the organised segment of commercial services.

The distribution of public outlay between Centre and States is determined by the respective resources generation capabilities, on the one hand, and the distribution of the developmental responsibilities between the Centre and the States, on the other. The State's own resources (Rs. 101,485 crores) will be augmented by making available Central Assistance for their Plan at a level of Rs. 78,500 crores. In some of the developmental heads and programmes, such as, family welfare, eradication of disease/epidemics, reduction of illiteracy, poverty alleviation, etc., the Centrally sponsored schemes may continue. However, the number of such schemes will have to be kept to the minimum most essential. In some sectors such as power, roads/highways, large industries, village and small industries and science and technology, the investments made through the Central Plan over the past 10 to 15 years have been significant, giving adequate leverage to the Centre for influencing the outcomes in these sectors. Further, expansion of the Centre's role will be at the expenses of the initiatives expected from the States and local authorities.

The Central Sector bears a residual responsibility for the plan objectives to the extent that these could not be realised through the State Plans or through private sector initiatives. At the same time it needs to be admitted that the traditional accounting and supervision mechanisms for keeping watch on public sector spending have not been fully effective. A more purposive identification of beneficiaries and focussed targetting in respect of public sector expenditure is essential if the Government has to perform its role in the face of severe resource shortages. Programmes need to be evaluated by organisations other than those which administered them. Programme Evaluation Organisation in the Planning Commission, National Sample Survey Organisation and well reputed research instituions will have to be constantly involved with the task of evaluation of programmes and preference.

TABLE 34.3

Sectoral Investment During the Eighth Plan (1992-93 to 1996-97)

(Rs. crores at 1991-92 prices)

Sector	*Public*	*Private*	*Total*	*Share of Public Sector in Total Investment by Sectors (%)*	*Sectoral Distribution*		
					Sixth Plan	*Seventh Plan*	*Eighth Plan*
(1)	*(2)*	*(3)*	*(4)*	*(5)*	*(6)*	*(7)*	*(8)*
Agriculture	52000	96800	148800	34.95	15.24	11.23	18.65
Mining & Quarrying	28500	11100	39600	71.97	6.06	6.70	4.96
Manufacturing	47100	141300	188400	25.00	23.60	26.00	23.61
Electricity	92000	10120	102120	90.09	12.07	13.65	12.80
Constuction	3300	17940	20540	16.07	2.73	1.86	2.57
Transport	49200	38710	87910	55.97	9.42	9.93	11.02
Communication	25000	1000	26000	96.15	1,50	2.03	3.26
Services	63900	120730	184630	34.61	29.38	28.60	23.13
Total	361000	437000	798000	45.24	100.00	100.00	100.00

Note: Sixth & Seventh Plan figures are calculated at 1980-81 prices.

TABLE 34.4

Sectoral Value Added and Employment Growth During the Eighth Plan (1992-97)

Sector	*Sectoral Growth*	*Empoyment Elasticity*		*Employment Growth*	
		Achieved 1977-78 to to 1983	*Achieved 1983 to 1987-88*	*Target for 8th Plan*	*Using Elasticity as in (5)*
(1)	*(2)*	*(3)*	*(4)*	*(5)*	*(6)*
Agriculture	3.02	0.49	0.36	0.50	1.51
Mining and Quarrying	8.08	0.67	0.85	0.85	6.87
Manufacturing	7.46	0.68	0.26	0.50	3.73
Construction	4.74	1.00	1.00	1.00	4.74
Electricity	8.18	0.74	0.48	0.50	4.09
Transport & Communication	6.39	0.92	0.35	0.60	3.83
Other Services	5.99	0.99	0.42	0.70	4.19
Total	5.6	0.58	0.31	0.47	2.61

Employment

With the planned pattern of investment and production, the employment potential will grow at about 2.6 per cent per annum. In absolute terms it implies generation of about 8 million jobs per annum during the first couple of years of the Eighth Plan, and about 9 million jobs per year during the latter years, and more than 10 million jobs per year in the post-Eighth Plan period. These employment projections are based on projected employment elasticities, which, in turn are based on plans to increase agricultural intensity and agricultural productivity, particularly in the eastern region and the dry belts. The pattern of industrialisation and choice of technique, wherever possible without scarificing productivity, have to be such as to increase the possibility of labour absorption in manufacturing and other sectors. Services will also have to play a major role in generating employment.

TABLE 34.5

Sectoral Growth Rates of Gross Value Added at Factor Cost (GVA) and Value of Gross Output

		Projected Growth Rate 1992-93 to 1996-97 (per cent per annum)		*Sectoral Share in GDP (per cent)*	
Sector	*Trend Growth Rate of G.V.A. 1981-82 to1990-91 (10 Years)*	*G.V.A.*	*Value of Gross Output*	*1991-92*	*1996-97*
(1)	*(2)*	*(3)*	*(4)*	*(5)*	*(6)*
Agriculture	3.77	3.02	4.05	27.66	24.45
Mining and Quarrying	6.78	8.08	9.11	2.04	2.30
Manufacturing	7.19	7.46	8.16	21.50	23.46
Electricity	9.00	8.18	8.39	2.40	2.71
Construction	3.63	4.74	5.36	5.13	4.92
Transport	7.34	6.45	7.77	5.93	6.18
Communication	6.22	6.04	6.85	1.17	1.19
Services	6.50	5.99	6.60	34.16	34.79
Total	5.59	5.60	6.74	100.00	100.00

34

Development of Backward Areas

Regional disparities in development was/has been an important socio-economic and political issue in many countries. In some countries it has assumed such a sensitive dimension as to cause social and political turmoil.

It is no surprise that regional disparities is an important multidimensional issue in a country like India, characterised, as it is, by such geographical vastness, socio-cultural diversities and development problems. The National Committee on the Development of Backward Areas (Sivraman Committee) observes: "In a large country like India, disparities in levels of development in different parts are inevitable. Regions differ in their history, their resource endowment and environment, the level of infrastructural development and the attitude of the inhabitants to development opportunities. However, with the growth of communications and the spread of education, knowledge about what is happening in other parts of the country spread and quite naturally the prevailing pattern of regional inequalities becomes unacceptable. There is a demand to correct these inequalities which the political and administrative system has to take note of. Because of this the problem of regional development in general and of backward area development in particular has been recognised in our plans."[1]

Indeed, the importance of balanced regional development was recognised even while laying the foundation of the Indian democracy. The Directive Principles of State Policy, embodied in the Constitution of India, proclaims, under Article 38(1), that the State shall strive to minimise the inequalities in income, and endeavour to minimise the inequalities in status, facilities and opportunities, not only among individuals but also amongst groups of people residing in different areas or engaged in different vocations.

It was, however, with the Third Five-Year Plan that the issue of balanced regional development began to receive considerable attention. The

---

[1] National Committee on Development of Backward Areas, *Report on General Issues Relating to Backward Area Development* (New Delhi: Planning Commission, Government of India, November 1981) p.17.

Third Plan, which, for the first time, included a separate chapter on Balanced Regional Development, observed: "A large country with extensive natural resources viewing each phase of its development in the perspective of a long-term plan, has the means not only to realise a high and sustained rate of growth, but also to enable its less developed regions to come upto the level of the rest." Development of backward areas received more and more attention in the subsequent plans and a multi-pronged approach has been evolved for the development of the backward areas.

Identification of Backward Areas*

As the Chakravarthy Committee on Backward Areas observes, backwardness is a relative concept, particularly in a developing country like India. However, within the overall context of underdevelopment, observable patterns exist and areas with different kinds and severities of backwardness can be identified. Assuming that the total elimination of backwardness in the country is a long-term process, it is still necessary to identify levels of development, the factors with which such levels are associated and the features underlying structural backwardness.

This necessity arises for formulating strategies for long-term plans, immediate policy requirements and the choice of the instruments.

As the National Committee on the Development of Backward Areas (NCDBA) remarks, an important point, however, is that the backward area must have a potential for development and there must be some reason for supposing that by detailed planning, administrative and financial support the productivity of the area can be raised. Where there is no potential for growth, the answer lies in outmigration. Thus, for the purpose of planning, the areas identified as backward must have the following three key characteristics:

(a) They must have potential for development

(b) There must be some inhibiting factor which prevents this potential from being realised.

(c) There must be a need for special programmes to remove or mitigate the inhibiting factor and realise the full potential for development.

In other words, the concept of backwardness that is relevant for planned development is that an area is backward if it is in need of special measures in order to utilise its development potential to the full. In this context special measures are not merely a question of finance but will involve directional departures or changes in the complex of policies, programmes, technologies, and institutional arrangements in the various sectors of development.

There are broadly two bases for identifying backward areas, viz., index based approach and problem area approach.

---

*This Section is based on the Report of the NCDBA, *Ibid*.

Index Based Approach: The index based approach relies on some overall index for ranking areas and treat all areas below some cut-off point as backward. Since no single indicator available at the district or block level is considered adequate by itself, for this purpose, the statistical measure is built from a multiplicity of indicators. Since a number of indicators are used there has to be a procedure for weighting the separate indicators to aggregate them into a single measure. Thus, the index based approach requires specification of the following:

(i) A set of basic indicators.
(ii) A procedure for weighting or aggregating so that these indicators can be reduced to a single measure.
(iii) A cut-off point below which areas are to be considered backward.

The principal problem with the index based approach is that there is a great deal of arbitrariness at each one of the three stages listed above. This arbitrariness leaves much scope for disputation. An excluded area can argue for a different set of basic indicators or weighting systems or cut-off points which would be favourable from its point of view.

The index-based method was used for identifying the industrially backward areas in India. *Appendix 36.1* to this chapter shows the indicators used by the Pandry Committee and the Planning Commission for identifying industrially backward areas.

Problem Area Approach: This approach involves the identification of problem areas in different categories by specifying the constraints on development that can only be mitigated by special measures.

The usefulness of the problem area approach lies not so much in any higher degree of objectivity in the manner in which areas are identified. Its real usefulness for the purpose of planning lies in the fact that it avoids aggregating very different types of areas into one generalised category labelled 'backward'. Such aggregation can mislead and inspire attempts at uniform remedies for separate problems. Unlike the index based approach, the problem area approach is constructive in the sense that the process of defining and identifying backward areas itself suggests the nature of the remedies that have to be applied. For example, if an area is considered backward because it faces the problem of chronic drought then the main remedy suggested is drought proofing.

The difficulty with the problem area approach lies in ensuring that all problem areas are in fact taken into account. There is no sure way of ensuring that this has been done.

The problem area approach was used in India to identify problem areas for formulating programmes for their development. For more information, see the section 'Non-industrial Development Programmes'.

INDUSTRIAL DISPERSAL POLICY

An industrial dispersal policy which encourages the growth of industries in the backward areas and discourages or prevents industrialisation of developed areas is an important measure taken in many countries to achieve the objective of regional balance.

A discriminatory industrial licensing, fiscal, monetary, commercial and the public sector investment policies are often deployed to help achieve the desired pattern of industrial location and development.

There are four common methods to affect or influence the desired pattern of industrial location, viz., direct regulation, direct investment, incentives and disincentives.

Direct Regulation

Under direct regulation, the Government may impose a ban on the location of industries or certain industries in certain areas. For example, it may place a ban on the location of new units within and near large cities with a view to preventing further concentration. Industrial location policy in India is characterised by such a ban on location of new industrial units in metropolitan cities. Such a regulation would compel industrialists to look for alternate locations. Direct regulation may also take the form of requiring the existing units to change their location, the establishment of separate zones for different types of activities, etc.

Direct Investment

The state can also help achieve its locational objectives by a suitable public sector investment policy. In the socialist countries, generally, the public sector occupies a very important position. In some of the developing countries like India, the public sector has been assigned a dominant role in the industrialisation of the country. In such countries, the public sector industrial investment policy can be attuned to help achieve the locational objectives. In India, a number of large industrial projects, like the Steel Mills at Bokaro, Bhilai and Rourkela, have been located in backward areas. Public sector investment in economic infrastructure and social overheads in backward areas is required to attract industries there.

Incentives

The use of incentives to influence the location of private sector industries has become quite common. For example, a number of fiscal, monetary, commercial and physical incentives and subsidies are offered by the Central and State Governments in India to industries in backward areas with a view to luring them to these areas.

Disincentives

In contrast to the incentives which may be regarded as a positive approach, the disincentives may be regarded as a negative approach. The disincentives are meant to discourage industries in certain areas like large cities or areas which are, comparatively, industrially well developed. Such disincentives may include a location tax, higher tariff for power and other infrastructures, etc. Further, incentives for industries in other areas also mean disincentives in the developed areas.

Industrial Dispersal Policies and Measures

Industrialisation has been looked upon as an important instrument that can accelerate the growth of backward regions and help remove regional imbalances. Para 15 of the Industrial Policy Resolution, 1956, states: "In order that industrialisation may benefit the economy of the country as a whole, it is important that disparities in levels of development between regions should be progressively reduced. The lack of industries in different parts of the country is very often determined by factors such as the availability of the necessary raw materials or other natural resources. A concentration of industries in certain areas has also been due to the ready availability of power, water supply and transport facilities. It is one of the aims of National Planning to ensure that these facilities are steadily made available to areas which are at present lagging behind industrially or where there is greater need for providing opportunities for employment, provided the location is otherwise suitable. Only by securing a balanced and co-ordinated development of industrial and agricultural economy in each region can the entire country attain higher standards of living."

The role assigned by the planning authorities to industrialisation in the development of backward areas is evident from the following observations in the Third Plan: "Large-scale industries, specially basic and heavy industries, frequently serve as a spearhead of intensive and broad-based development. However, not all regions can offer equally favourable conditions for the development of industry. It is also possible to over-estimate the significance of the location of large industrial units in relation to the living standards of the bulk of the population. There are many examples, both of countries and of regions within a country, in which, with limited development in industry, an appreciable rise in living standards has been achieved through the fuller utilisation of local natural and human resources. There are also instances of areas around massive projects where no great impact on the levels of living of the people is to be observed. Apart from the basic and capital goods industries and other large industries, there are other industries whose possibilities need to be fully exploited, such as labour intensive industries of the traditional type, agricultural processing industries, forest industries, assembly operations and recreational industries. Each region should endeavour to identify, plan for and promote industries which are specially suited to its conditions and for which it can provide relatively greater facilities."[2]

---

[2] Government of India, Planning Commission, *Third Five-Year Plan* p.143.

The Industrial Policy Statement of 1977 states that, in order to check urban congestion, the "Government have decided that no more licences should be issued to new industrial units within certain limits of large metropolitan cities having a population of more than one million and urban areas with a population of more than 5 lakhs as per the 1971 census. State Governments and financial institutions will be requested to deny support to new industries in these areas such as those which do not require an industrial licence. The Government of India would also consider providing assistance to large existing industries which want to shift from congested metropolitan cities to approved locations in backward areas."

The new Industrial Policy announced by the Government of India on July 23, 1980, states that industrialisation will play an important role in correcting the regional imbalances and reviving the industrial growth to lead the economy once again to the take-off stage. For the achievement of this goal, the Government has decided to encourage the dispersal of industry and the setting up of units in industrially backward areas. Special concessions and facilities will be offered for this purpose, and these incentives will be growth and performance-oriented. It also proposes the setting up of a few nucleus plants in each district identified as industrially backward to generate as many ancillaries and small and cottage units as possible. A nucleus plant will concentrate on assembling the products of the ancillary units falling within its orbit, on producing the inputs needed by a large number of smaller units and making adequate marketing arrangements for their sale. The nuclei will also ensure a widely spread pattern of investment and employment and will distribute the benefits of industrialisation to the maximum possible."

The role of industrial dispersal policy in accelerating the development of backward areas and alleviating inter-regional development disparities has, thus, been well recognised. However, no commendable achievement has so far been made in this direction.

In the early phase of development, the emphasis was on the location of public sector enterprises in backward areas and on the development of industrial infrastructure in these areas. Specific programmes for attracting private sector investment to the backward areas began to be implemented only since the middle of the Fourth Plan.

The task of identifying the industrially backward areas was taken up by the Planning Commission, for the first time, at the beginning of the Fourth Plan by appointing a Committee under the Chairmanship of Mr.B. D. Pandey for suggesting criteria for identifying industrially backward states and backward districts in such states and another committee under the chairmanship of Mr. N. N. Wanchoo to suggest fiscal and financial incentives for industrial development in the backward areas.

The Pandey Committee, taking into account certain development indicators such as per capita income, per capita consumption of electricity, road and railway mileage, number of factory workers etc., identified, in 1969, the states of Andhra Pradesh, Assam, Bihar, Himachal Pradesh, Jammu and Kashmir, Madhya Pradesh, Nagaland, Orissa, Rajasthan and Uttar Pradesh and all Union Territories except Chandigarh, Delhi and Pondicherry as industrially backward (Pondicherry was also subsequently declared as backward).

Considering the criteria suggested by the Pandey Committee and in consultation with the financial institutions, the Planning Commission finalised the criteria for the identification of backward districts in all States/Union Territories, whether identified as backward or not by the Pandey Committee. Accordingly districts where the composite index of per capita production of foodgrains/commercial crops, per capita industrial output, factory employment, availability of infrastructural facilities, per capita consumption of electricity etc. was well below the state index were considered as backward.

The Planning Commission in consultation with the National Development Council decided that the incentives by the Central Government should be extended to only two of the backward districts in each of the backward States/Union Territories and to only one district in each of the other states.

Capital Subsidy

The Central government's incentive, introduced in 1971, for industrial investment in these districts was in the form of an outright grant/subsidy equivalent to 10 per cent of the total fixed capital investment or Rs.10 lakhs whichever was less. All the districts identified as backward including those eligible for the central subsidy, were eligible for concessional finance from the all-India financial institutions. Most State Governments introduced their own incentive schemes. The number of districts eligible for the Central subsidy was later increased to 6 districts in each backward state and 3 districts in each of the other states. For units established after 1-3-1973, the rate of subsidy was enhanced to 15 per cent subject to a ceiling of Rs.15 lakhs.

Modified Scheme

In April 1983, the backward area development scheme was revamped with a view to providing further impetus to the industrialisation of backward areas. The new policy divided the backward areas into the following three categories:

Category A comprising of 42 no industry districts and 76 special region districts (118 districts in total).

Category B comprising of 55 districts (districts previously eligible for central subsidy minus the districts included in category A).

Category C comprising of 113 districts (the 246 concessional finance districts minus the districts included in categories A and B).

New industrial investments in these categories of districts were offered central subsidy at the following rates:

Category A : 25% subject to a maximum of Rs.25 lakhs
Category B : 15% subject to a maximum of Rs.15 lakhs
Category C : 10% subject to a maximum of Rs.10 lakhs

With this policy, districts in category C which were hitherto eligible for only concessional finance, also became eligible for the central subsidy. All the three categories continue to enjoy the benefit of the concessional finance, in addition to the investment subsidy.

With effect from 1st April, 1985, the ceiling on the subsidy was raised from Rs.25 lakhs to Rs.50 lakhs in case of electronics industries set up in Hill districts.

The Scheme was later revised and according to that the blocks/taluks/ urban agglomerations/extensions of townships in categories B and C districts where investments have exceeded Rs.30 crores as on 31st March 1983 are not eligible for further investment subsidy or concessional finance.

The number of districts in the three categories has also been revised. When the modified scheme was introduced in 1983, there were, in all, 246 backward districts/areas; but more districts were added to the list periodically and as on June, 1987, there were 301 of them (134 in category A, 54 in B and 113 in C).

Nucleus Plants: As rapid industrialisation of backward areas would be facilitated by providing an impetus for the setting up of such industries as can promote the development of ancillary units in the areas, Government introduced a shceme to recognise certain industrial units of this type in the backward areas as nucleus plants. The nucleus plant was expected to promote new ancillaries as part of its programme of 50 per cent ancillarisation and to provide for at least three times direct employment in the ancillaries. This scheme was in force from 1st April 1983 to 31st March 1986.

Assistance for Infrastructural Development: In June 1984, the Central government issued certain guidelines in respect of assistance for the development of infrastructural facilities in no industry districts. The Central assistance was limited to one-third of the total cost of infrastructure development, subject to a maximum of Rs.2 crores per district. Assistance was available for projects set up in two growth centres in each no industry districts. The details are given in *Appendix 36.2* to this chapter.

State Incentives

Most State governments have been offering their own schemes of incentives to lure industries to their backward areas. These schemes are not alike in all respects. Important incentives and assistance offered by the states include:

(a) exemption from payment of Octroi on capital goods and raw materials;

(b) refund of State Sales-Tax paid on purchase of capital goods and raw materials;

(c) exemption from payment of electricity tax;

(d) exemption from payment of alienation charges for the purchase of land for industrial purpose;

(e) allotment of land required for industry in the industrial areas on lease-cum-sale basis;

(f) full exemption to new industrial investments from payment of royalty on water drawn from public sources;

(g) subsidisation of cost of preparation of feasibility reports;

(h) technical guidance and training programmes for new entrepreneurs;

(i) concessional finance from State level institutions, etc.

Concessional Finance

All-India financial institutions — IDBI, IFCI and ICICI — formulated scheme of concessional finance which was modified from time to time. This involved, broadly, the following:

(i) Loans at concessional rate of interest.

(ii) Extended amortisation and moratorium periods depending upon the merits of each case.

(iii) Lower contribution by promoters to the total project cost and accordingly somewhat liberal debt-equity ratio.

(iv) Greater participation in debt or preference capital as compared to projects being set up elsewhere

(v) Concessions in respect of certain charges like commitment charges.

(vi) Concessions in respect of underwriting commission and commission on deferred payment guarantees.

After the grouping of the backward areas into the three categories, larger concessions were made available to industries in the A category areas.

The Industrial Development Bank of India provided refinance at concessional terms in respect of loans granted by eligible credit institution, viz., commercial banks, State Co-operative Banks, Rural Banks, State Financial Corporations and State Industrial Development Corporations/State Industrial Investment Corporations, for the projects set up in backward areas. Refinance is provided to the extent of 100 per cent of the loan amount granted by eligible institutions to units in backward areas, subject to certain conditions.

Assistance under the Bills Rediscounting Scheme was provided at reduced discount rates, depending on unexpired usance of the bills to the State Electricity Boards and State Road Transport Corporations in the North-Eastern and Himalayan Hill Regions as also to West Bengal State Electricity Board for use in the district of Darjeeling.

New Policy

With a view to accelerating the industrial growth and giving a strong impetus to the industrialisation of backward areas, Government announced in June 1988 a package of delicensing and incentives. The salient features of it are given below:

Delicensing: With a view to encouraging investment in the backward areas, projects of non-MRTP/non-FERA companies have been exempted from industrial licensing if the investment in fixed assets does not exceed Rs.50 crores as against Rs.15 crores in non-backward areas, subject to certain conditions*

Development of Growth Centres: It may be noted that, for accelerating the development of backward areas, the idea of development of growth centres has been mooted for quite some time now. The new policy has stated that, for promoting industrialisation of backward areas in an effective manner, the focus would henceforth be on the development of growth centres that would act as the magnet for attracting industries to backward areas. Such growth centres would be endowed with infrastructural facilities on par with the best available in the country, particularly in respect of power, water, telecommunication and banking.

To begin with, at least 100 such growth centres would be selected and developed over a period of about five years. Thereafter, the development of growth centres would be further expanded so that over 10 to 15 years since the introduction of this scheme most of the backward areas of the country would be covered. The ultimate objective will be to develop one growth centre in each of the 430 and odd districts in the country.

The growth centres are to be located within a reasonable proximity of district headquarters or tehsil headquarters in backward areas at such places that have a good potential for attracting industries.

The scheme envisages to provide each growth centre with Rs.25 to Rs.30 crores in order to create infrastructural facilities of high order. Development of 100 growth centres over the period of 5 years will, thus, involve an investment of Rs.2,500 to 3,000 crores. This will be funded by the Centre, the States and the all-India financial institutions acting together.

It may be noted that the development of the growth centres is in addition to the existing backward area development scheme (i.e., the scheme of incentives for industrial location in category A, category B and category C areas described earlier) and is not in substituion of it. However, the backward area scheme would be reviewed periodically with the progress in the establishment of the growth centres and such modifications will be made in it as are necessary.

---

* For details, see the chapter on *Industrial Policy*.

Financial and Monetary Incentives: The backward areas continue to receive financial and monetary incentives. Any new industrial undertaking established in a centrally declared backward district is eligible to income-tax relief under Section 80HH of the Income Tax Act by way of deduction of 20 per cent of the profits for a period of 10 years. Furthermore, under Section 80I of the Income-Tax Act, all new industrial undertakings are entitled to an income-tax relief by way of deduction of 25 per cent of the profits for a period of 8 years. The benefits of both these sections are available cumulatively to industrial undertakings established in notified backward areas. They will also be eligible to claim the investment allowance scheme. All these benefits will be available both to the industrial units established in the growth centres as well as those located in other centrally declared backward areas.

It has also been stated that the norms for working capital funds required by industrial units established in backward areas would be reviewed and they will be accorded more liberal treatment.

The Government announcement states that the ultimate objective will be to develop one growth centre in each of the districts in the country. When a number of districts like those districts with metropolitan and other very large cities and industrial agglomerations are already facing problems of concentration and congestion it is rather ironic to state that we should aim at developing growth centres in all the districts of the country. It is quite obvious that many districts shall have to be excluded from it.

NON-INDUSTRIAL DEVELOPMENT PROGRAMMES

Although industrialisation as an instrument of development of backward areas has been very popular, it is not the suitable or the only instrument for the proper development of several backward areas. Indeed, some areas do not favour or lend themselves to industrialisation on a significant scale. Further, industrialisation has it own limitations in trickling down and spreading growth impulses. This has been evident from the Indian experience. A number of large-scale public sector industrial projects have been located in the backward regions and the private sector has been offered wide ranging incentives for locating their units in such regions. But it has now become evident that the "organised industry, which tends to be capital intensive, is not necessarily the sort of growth catalyst that backward areas need. Our experience with large industrial projects in backward areas shows that their spread effects are low and the surrounding areas continue to remain poor and underdeveloped. In fact, such development by creating a dualistic economic structure may pose more problems than it solves. These arguments are applicable not merely to large public sector projects but also to modern private sector industry. Industrialisation can play an important role in some backward regions, particularly those that are densely populated and have few opportunities for traditional non-agricultural occupations. There is also the need to increase the geographical dispersal of industry to avoid problems of pollution and congestion in big cities. But the promotion of industry as a tool for the development of backward areas requires a degree of selectivity about the types of industries promoted and the area choosen for such promotion. It is necessary that the incentive schemes to promote the industrialisation of backward areas be examined to assess their costs and effectiveness in promoting overall development in the area concerned."[3]

There has, thus, been a growing realisation of the importance of non-industrial development programmes for activating economic development and improving the living conditions in the backward areas. Indeed, a combination of several development measures is needed for the overall development of many backward areas.

Specific development programmes designed to suit particular backward areas have gained greater attention in recent years. The National Committee on the Development of Backward Areas in its Report submitted in November 1981 emphasised the importance of the *Problem Area Approach* to the development of backward areas. The Committee observed: "The specificity of technological possibilities, variations in the sectoral mix of economic activity, differences in infrastructure requirements and difficulties in the participation of local people in the economic activities, will to some extent, be found in almost any area. However, there are certain areas where these problems are of an order that requires special measures."[4]

The NCDBA, therefore, recommended that the following types of problem areas be treated as backward for purpose of planning:

(i) Chronically drought prone areas
(ii) Desert areas
(iii) Tribal areas
(iv) Hill areas
(v) Chronically flood affected areas
(vi) Coastal areas affected by salinity

The Committee felt that these six categories can be "viewed as six types of fundamental backwardness. In this sense an area may suffer from the handicap of more than one type of fundamental backwardness."[5]

---

[3] Government of India, Planning Commission, *Draft Five-Year Plan*, 1978-83, p.11

[4] National Committee on the Development of Backward Areas, *op.cit.*

[5] *Ibid.*, p.39.

Programmes for the development of such problem areas and other backward areas were employed in India even much before the recommendation of the National Committee.

Various rural development programmes were introduced since the First Plan. There was a proliferation of such programmes in the seventies. Several of these programmes were introduced to promote the development of areas facing special handicaps and to assist the development of small and marginal farmers and landless and agricultural labourers. These programmes were begun with the realisation that the benefits of normal agricultural and rural development programmes were not reaching certain types of areas and the rural poor. Hence, these programmes were designed as direct measures to reach the rural poor. However, in practice, these programmes were reduced to mere subsidy giving programmes short of any planned approach to the development of the rural poor as an inbuilt process in the development of the area and its resources. The Sixth Plan, therefore, decided to put an end to such multiplicity of programmes for the rural poor operated through a multiplicity of agencies and replace them by a single integrated programme operative throughout the country, namely the *Integrated Rural Development Programme* (IRDP). The main objective of the IRDP has been to operate an integrated strategy for the purpose, on the one hand, of increasing production and productivity in agriculture and allied sectors based on better use of land, water and sunlight, and on the other of the resource and income development of vulnerable sections of the population in all the blocks of the country.

As stated earlier, the Problem Area and Resource Area development programmes have been in operation in India for quite some time now. They gained great significance particularly since the Fifth Plan.

Greater attention has been given recently to the development of certain hill and other problem regions, particularly because of the political sensitiveness and vulnerability of these regions.

Development/devolution of financial resources is an important factor that affects development. Besides the resources allocated to the specific programmes, special treatment is supposed to be given to the backward states in the financial allocations by the Central Government. Various Finance Commissions have given certain weightage to backwardness in the criteria for allocation of funds amongst the States.

One of the important objectives of bankisation of the rural areas has been to make bank finance available in these areas. Particularly since the bank nationalisation of the 1969, great emphasis has been laid on spreading the banking facilities to the rural areas. The services of the Regional Rural Banks (RRBs) have been rapidly spread in the rural areas with view to increasing the credit deployment for accelerating rural development. Minimum credit-deposit ratio has been specified for commercial banks to check the siphoning off funds from the backward to the developed areas.

AN ASSESSMENT

The development exercises of nearly four decades do not appear to have made any significant favourable impact on the regional economic disparities. Not only that, development indicators also show a widening of the inter-regional gap in several spheres, although certain measures have promoted development in many backward areas.

As has already been pointed out, the large industries located in backward areas failed to generate the expected level of growth impulses.

The investment policy of the Central and State Governments can be one of the effective tools to correct the regional imbalances in development. It is true that some backward States have received considerable Central sector investment and several public undertaking have been located in backward areas. But, it is a disquieting fact that a large share of the Central investment in the industrial sector has gone to those very States which account for a large chunk of the private sector industrial investment and which are industrially advanced states. A large part of the industrial investment by both the Central and State governments is concentrated in and around metropolitan and large cities, resulting in the aggravation of various urban problems and the widening of inter-regional and intra-regional disparities.

The share of some of the poor States in the total Central government industrial investment has been continuously declining. For example, in 1987 Kerala which accounted for about 3.7 per cent of the Indian population received only about 1.6 per cent of the Central investment.

The industrially advanced States like Maharashtra, Gujarat, Tamil Nadu, West Bengal and Karnataka continue to account for a major share of the new industrial activities. They have also received a disproportionately large share of the loans from the all-India financial institutions. What is more ironic is that a disproportionately large share of the loans sanctioned to the backward areas has also gone to these developed States. This may indicate that the backward areas of the backward States lag behind those of the developed States in industrial development even under the stimuli of the backward area developmen scheme. About 70 per cent of the total number of the districts in India are notified as industrially backward; but in 1986-87, projects in the backward districts accounted for only about 40 per cent of the total assistance sanctioned by all financial institutions in India, despite the fact 1986-87 recorded a substantial increase in the assistance to the backward areas over the previous year.

Further, a look at the *investment + credit - deposit* ratios of the commercial banks makes it very clear that they have been instrumental in siphoning off the resources from the backward areas and states to the developed areas and states. The financial institutions in India have, thus, been instrumental in reallocating the national resources in favour of the developed areas and states at the expense of the backward areas and states.

The inter-state equity principle has been violated also by the pattern of resource transfers from the Centre to the States. Only about 40 per cent of these transfers is covered by the Finance Commissions' recommendations and the remaining part of the transfers has taken place through other agencies. It has been pointed out that even though Finance Commission transfers themselves have not been as equalising as one would have liked them to be, the fact remains that resource allocation through most other agencis has been quite regressive.[6]

However, certain measures have some favourable effects on the development of backward areas, even though they by themselves are not sufficient enough to remove the disparities. Particularly since the introduction, in 1983, of the modified scheme for industrialisation of backward areas, with emphasis on the no-industry districts, a number of industries have been coming up in the backward areas, although their share is still lower compared to that of the developed areas. The new policy introduced in June 1988 involving a much higher exemption limit of investment from licensing and development of growth centres is expected to further improve the situation. In fact, the growth centre strategy for development of backward areas has been well known for quite a long time now. It is unfortunate that the Government should have waited until now to take steps to implement this strategy. More incentives are needed for development of backward areas.

---

[6] K.K. George, *Centre—State Financial Flows and Inter-State Disparities* (Delhi : Criterian Books), 1988.

35

State and Agriculture

Agriculture contributes over one-third of India's GNP, provides livelihood for over two-thirds of the population, supplies raw materials for a number of important industries and makes a significant contribution to export earnings.

The development of agriculture is necessary to help solve the twin problems of unemployment and poverty. In fact, rural India represents one of the largest potential markets in the world for many manufactured products. This makes it quite clear that the development of the industrial and other non-agricultural sectors depends to a very large extent on the prosperity of the agrarian sector.

Phases of Development

As the Sixth Five-Year Plan (1980-85) document points out, starting from the beginning of this century, three major phases may be identified in our agricultural evolution. The first phase from 1900 to 1947 was marked by a near stagnation in farming, as is clear from a growth rate of about 0.3 per cent per annum achieved in agricultural production during this period. Phase II extending from 1950 to 1980, has been marked by considerable advance in the process of modernisation of agriculture, thanks to the steps taken in the development and spread of:

(a) Technologies based on scientific research;
(b) Wide range of services; and
(c) Public policies on land reform, pricing, procurement and distribution.

As a result, agricultural production grew at an annual compound rate of 2.8 per cent during 1967-68 to 1978-79. The third phase, which has begun in the eighties, is marked by the need for greater attention to marketing and trade, and to institutional frameworks which can help to minimise the handicaps of small and marginal farmers and maximise the benefits of intensive agriculture offered by small holdings.

EXPANSION AND DEVELOPMENT OF INPUTS AND SERVICES

It has been indisputably proved that input expansion and development in agriculture can bring about a significant output expansion and remarkably increase labour absorption.

Our Five-Year Plans have emphasised the role of agriculture in national development, and the Central and State Governments have taken a number of steps to develop the agrarian sector. Some of these important measures are reviewed in the following paragraphs:

Irrigation is one of the important inputs that significantly increase agricultural productivity and employment opportunities. The Union and State Governments have been endeavouring to expand the area under irrigation by executing major, medium and minor irrigation projects and exploiting the ground-water potential. Rural electrification programmes, too, have been given importance so that they may help improve agricultural operations by facilitating the energisation of pump-sets, etc.

A far-reaching event in the annals of Indian agriculture was the introduction of high-yielding varieties (HYV) of a number of field crops and bybrids of millets in particular. This programme covers major food crops, namely, wheat, rice, maize, *jowar* and *bajra*. The success of this programme has revolutionised agriculture and brought about a phenomenal and rapid increase in foodgrains production in the country. The high-yielding variety programme is one of the most important planks of the new agricultural strategy. The area under HYV seeds has been showing a progressive increase from year to year.

The National Seeds Corporation (NSC) and State Farms Corporation of India (SFCI) were set up in 1963 and 1969 respectively by the Government of India for the supply of quality seeds.

Farm research in the country is carried out and co-ordinated by a number of public and quasi-public institutions, spearheaded by the Indian Council of Agricultural Research (ICAR). The Department of Agricultural Research and Education, set up in 1973, is responsible for co-ordinating research, education and extension education in the field of agriculture, animal husbandry and fisheries in India. Besides, it also helps in bringing about inter-institutional and intra-institutional collaboration, both at national and international levels, among agencies like the International Atomic Energy Agency and FAO engaged in allied fields.

The Government of India, the Reserve Bank of India and the State Governments have made commendable efforts in the field of agricultural credit. The co-operative structure, with its country-wide network of primary co-operatives, the commercial banks the Regional Rural Banks (RRB), are the three main agencies involved in the provision of credit for agriculture and allied sectors. Of the three, it is the co-operatives which still continue to have the predominant role in terms of both volume and territorial coverage

With a view to bringing about better co-ordination in the credit policies impinging on short, medium and long-term financing of agriculture and allied activities, including marketing, processing and shortage, as well as rural industries, it was decided to establish a National Bank for Agriculture and Rural Development (NABARD). It is an apex re-financing institution in the country for these activities and will combine the developmental and financial roles which were hitherto being performed by the RBI and the Agricultural Refinance and Development Corporation (ARDC).

Steps have been taken for plant protection, soil conservation, drought-prone area development, etc.

The Agro Service Centre Scheme was introduced in 1971 with the twin objectives of providing employment to trained entrepreneurs and providing inputs to farmers at their doorsteps at reasonable prices.

The Food Corporation of India (FCI), set up in 1965, serves the nation in the vital areas of procurement, distribution, storage and movement of foodgrains. It also performs other diversified activities, such as rice milling and production of nutritious processed foods.

The Central Warehousing Corporation acquires and builds godowns and warehouses for the storage of agricultural produce, inputs, implements and notified commodities. There are also State Warehousing Corporations.

AGRICULTURAL MARKETING

As the Sixth Five-Year Plan document observes a marketing system, which protects the interests of both producers and consumers, is the backbone of agricultural development. Such a marketing system must have three essential elements:

(i) A suitable structure of suport prices for various agricultural commodities adjusted from time to time in the light of the cost of production so as to ensure fair returns to the farmers;

(ii) Adequate arrangements for the procurement of agricultural produce at support prices if the prices fall below that level; and

(iii) A well-spread-out and regulated infrastructure of marketing which will ensure a fair price to the producer in open market conditions and help eliminate the non-functional marketing margins of intermediaries.

The Union and State Governments have taken a number of measures with the objective of ensuring that the above conditions are satisfied.

The Agricultural Price Policy (it has been dealt with in some detail at the end of this chapter) seeks to achieve the first of the abovementioned three objectives.

The principal public agencies involved in support price operations (procurement) on behalf of the Government to achieve the second objective are the Food Corporation of India, the Cotton Corporation of India, the Jute Corporation of India and the Co-operatives with the National Agricultural Co-operative Federation of India (NAFED) as their apex organisation. Besides, some State Governments have also been procuring agricultural produce, particularly foodgrains, on support prices, either departmentally or through their own Civil Supplies Corporations.

To achieve the third objective, a number of steps have been taken since the commencement of planning, aimed at regulating the marketing practices, standardising weights and measures, developing suitable infrastructure facilities in assembling markets, introducing quality standards through *Agmark* certification, etc. The Agricultural Produce Markets Act is an important piece of legislation aimed at improving agricultural marketing practices.

Directorate of Marketing and Inspection

The establishment of the Directorate of Marketing and Inspection was a very important step. The important functions of the Directorate are:

(i) Giving advice to the Central and State Governments on agricultural marketing problems;

(ii) Promoting the grading and standardisation of agricultural and allied activities;

(iii) Statutory regulation of markets and market practices;

(iv) Training of personnel;

(v) Market extension;

(vi) Market research, planning and survey; and

(vii) Administration of the Cold Storage Order, 1964, and Meat Food Products Order, 1973.

The Directorate enforces compulsory quality control before export on as many as 40 agricultural commodities. The important commodities graded under *Agmark* for internal consumption include cotton, vegetable oils, ghee, cream, butter, eggs, rice, wheat, atta, jaggery, potatoes, pulses, Kangra tea, honey and ground spices. To ensure the purity and quality of the products graded under *Agmark*, a number of laboratories have been set up in different parts of the country. The Directorate has formulated grade specifications for 113 agricultural commodities and grading instructions for 78 commodities.

Regulated Markets

Over the years, a number of regulated markets have been established to eliminate unhealthy marketing practices, reduce marketing charges and to ensure fair prices. *The regulated market is a market the activities of which are regulated by law and is meant for dealing in a specific commodity or group of commodities.*

The regulated market is administered by a committee which represents different interests like the State Government, local institutions, traders, brokers, commission agents and farmers. The committee regulates the various activities connected with sales and purchases in the market. For instance, it issues licences to the functionaries of the market, fixes charges for weighing, brokerage, etc., ensures the use of standard weights and measures, and provides for the supervision and check-up of proper weighing and measuring. There are also arrangements for the settlement of disputes and punishment of the guilty.

The main objective of the regulated market, obviously, is to save the farmers from the exploitation of unscrupulous market intermediaries and to ensure a fair price for their produce.

The regulation of markets is the responsibility of State Governments. The Directorate of Marketing and Inspection renders advice on framing market legislation and its enforcement.

Co-operative Marketing

The co-operative sector has been assigned an important role in agricultural marketing too. The National Co-operative Marketing Federation of India (NAFED) has been playing a useful role in this respect.

The co-operative movement has been promoted with the objective of helping the small farmers. Co-operative agencies can play a vital role by arranging to collect the produce of the small farmers, grading and storing it, and helping them to sell at an advantageous price. In short, co-operatives are expected to reduce market imperfections, render the required marketing services and to ensure fair prices. It should be noted that marketing is only one of the important functions of the co-operative sector.

AGRICULTURAL PRICE POLICY

The agricultural price policy is essentially a part of the general price policy which is an important ingredient of the national economic policy. The fact that nearly two-thirds of the Indian population directly depends upon agriculture and that about 35 per cent of the national product is generated by this sector indicates the importance of agricultural price policy in India.

The agricultural price policy of the Government of India has three main objectives:

(i) To ensure a remunerative price to farmers;

(ii) To ensure the supply to the consumers at reasonable price; and

(iii) To establish a structure of relative prices which achieves a desirable cropping pattern.

To achieve the first objective, the Government fixes, from time to time, *Minimum Support Price/Procurement Price* for a number of commodities. The distribution at reasonable prices of certain commodities like foodgrains procured by the Government at prices fixed by it facilitates the achievement of the second objective. The third objective is achieved by making appropriate variations in the relative price structure.

The Commission for Agricultural Costs and Prices (CACP) recommends to the Government the prices that may be fixed for different agricultural commodities. While recommending the prices, the CACP is guided by the three objectives mentioned above. The policy of the Government, as mentioned above, is that the role of agricultural pricing policy should not be limited only to ensuring remunerative prices to farmers, but should also extend to achieving a better inter-crop balance through a desirable cropping-mix and reducing the existing variability of agricultural production and its consequent effects on the price levels and national income.

Today, agricultural commodities like wheat, paddy and coarse grains have *procrement prices* fixed for them; the *minimum support price* operates for several commodities — like barley, gram, arhar, moong, urad, mustard, groundnut, sunflower seed, soyabean, and cotton (kapas); and sugarcane, jute and tobacco are subject to *statutory minimum price*.

Purchases of the commodities controlled by the procurement/minimum support prices are made by official agencies. For instance, the Cotton Corporation of India purchases cotton, the Jute Corporation of India purchases jute and the National Agricultural Co-operative Marketing Federation purchases commodities like oil-seeds, pulses, onions, potatoes, etc.

However, it has been found in many instances that the Government agencies like the Cotton Corporation of India, the Jute Corporation of India, the National Agricultural Co-operative Marketing Federation, etc., are not sufficiently equipped to efficiently carry out the large-scale purchase operations that are required to ensure the minimum price to the farmers. The result is that the expected benefits do not often reach the producers.

Despite the price support policies of the Government, the fact remains that the prices of many agricultural commodities are not remunerative enough. In case of many agricultural commodities, the Government has not taken any effective action to arrest the fall in prices to unremunerative levels.

In the last three decades, the terms of trade between the agricultural and non-agricultural sectors have moved very clearly against agriculture. Between 1978-79 and 1979-80, the increase in agricultural prices lagged behind the rise in industrial prices by 10 per cent. As the agricultural prices could not keep parity with the manufactured prices in the years 1978-79 and 1979-80, the agricultural sector lost an income of the order of Rs. 3,900 crores. A loss of this order in a single year is a matter of great concern, for agriculture shelters nearly three-fourths of the population of the country. Even if we assume that trade between agriculture and industry makes up only a third of the national product, it implies that, through the price mechanism, the inudstrial sector was able to "plunder" about Rs. 1,500 crores from farmers in 1979-80 alone. In 1985-86, the index for prices of manufactured products was 110.7 per cent of the index for prices of agricultural prices. The trend reversed in recent years.

Such price divergences have resulted in the impoverishment of the agricultural sector and an increase in the rural-urban income drift. The growing disparity between rural-urban incomes was pointed out by the National Commission on Agriculture: Between 1960-61 and 1973-74, while rural income (at 1960-61 prices) increased by 62.95 per cent, or at 2.12 per cent per annum, the income in the urban sector increased by 188.71 per cent, or at 4.72 per cent per annum (compound). The urban income, which was 0.77 times the rural income in 1950.51, increased to 1.38 times the rural income in 1973. In per capita terms, the rural income increased by only 4.64 per cent between 1950-51 and 1973-74; but the urban income increased by 49.17 per cent. In other words, in 1950-51, the national product attributable to one person in the urban sector was 3.7 times that of the person in the rural sector; in 1973-74 the urban product per person was 28 times the product attributable to a person in a rural area. This is how disparity between the rural and urban sectors has widened over the years. According to the CSO, the per capita national income derived from agriculture at 1970-71 prices has stagnated around the same figure as it was in 1950-51. The per capita national income derived from the manufacturing sector has more than doubled. The stagnation in agricultural income was not due to stagnation in agricultural production. In fact, agricultural production has increased at a faster rate than the growth in population. Thus, in spite of higher per capita agricultural production, the average income of the agriculturists has stagnated.

In short, there has been taking place a disguised transfer of income out of agriculture to the industrial sector. Here is a classic example of the change in the terms of trade between agriculture and industry: "Five years ago the farmer had to sell 200 quintals of wheat to purchase one tractor. But today he has to offer 500 quintals of wheat for the same tractor." This income drain due to the relative decline in agricultural prices has far-reaching implications. A number of arguments have been forwarded to support this agricultural prices' depressive policy. In the remaining part of this section, we shall examine these arguments critically.

An impression has been deliberately created in this country that higher prices for farm output will benefit only the rich farmers. In fact, this argument is far from true; it is based on a number of wrong and inept premises. We should like to contradict this thesis on the following grounds.

One of the arguments is that small farmers consume the whole of the output of their land, and hence, in the absence of marketable surplus, they do not benefit from high prices! Therefore, high prices help only the rich farmers. The proponents of this thesis make an inept assumption that small farmers produce only food crops. But in reality there are a very large number of small farmers who do not produce any crops for their own consumption but produce only for the market.

Even in the case of a number of food crops other than the staple food, family consumption forms only a small part, if at all, of the total output of the owned land.

Further, even in the case of small farmers who raise only their own staple food, they have to sell a part of their produce—even by sacrificing their food sometimes—to obtain money for their other requirements. In such cases, a higher price will in fact increase the consumption level of the poor farm families, for at higher prices they will have to part with only a lesser quantity of output to obtain a given amount of cash.

All these facts tell us that small farmers stand to benefit from higher prices for their produce.

It has also been argued that small farmers sell their produce immediately after the harvest at throw-away prices, for they are badly in need of cash and the traders take advantage of this. Hence small farmers will not get the benefit of higher procurement prices. We should like to emphasise here that if this is the situation, it clearly exposes the inadequacy of institutional measures to protect the interests of small farmers. It is not a case against high prices, but it exposes the failure of the Government to take effective steps to ensure social justice. If a life saving medicine is not within the reach of a poor patient, the solution is not to ban the medicine but to make the necessary arrangements to ensure its availability to him. Second, unless farming is made a remunerative business by ensuring reasonably high prices, the economic conditions of agricultural labour cannot be improved. Of course, higher agricultural prices need not necessarily ensure higher wages for labour; but it is a necessary pre-requisite for facilitating the payment of higher wages. In several parts of Kerala, where farm wages are relatively high, there has been a fall in the demand for labour, especially by small farmers, as the output prices have not been remunerative enough for them to operate at high costs.

High agricultural prices will benefit farm labour when wages are paid, in part of full, in kind. Even in a comparatively well monetised State like Kerala, in some places, farm labour demand wages in kind.

While labour in the organised industrial sector and the Government sector enjoy a number of welfare schemes and fringe benefits, they are almost completely denied to agricultural labour. An impression has been created by the writings of many economists and others that agricultural labour is denied a satisfactory wage and welfare amenities because of the exploitative attitude of agricultural employers. But the fact is that in the absence of remunerative prices for their produce, agriculturists are not capable of paying higher wages and contributing to labour welfare. On the other hand, the monopoly and oligopoly elements present in the organised industry of the country enable it to absorb higher wages, fringe benefits, expenditure on labour welfare and the like into their prices.

The industrial sector is allowed to abosrb many expenditures that are even extravagant into their calculation of price. But the statutory bodies concerned with the computation of agricultural prices do not take into account even certain inevitable cost items. Unless and until the agricultural price calculations are based on a realistic premise, agricultural labour cannot expect to get many of the benefits their counterparts in the industrial sector enjoy.

Another argument advanced in support of the suppression of agricultural prices is that higher prices for farm output will fuel inflation. At the outset, it would appear to be very correct. But it is quite clear to everybody that sugar price is very high not because the sugarcane price is very high; even when the price of natural rubber was very low, the tyre prices were substantially raised. Further, agricultural prices can be raised without adversely affecting consumer prices if effective steps are taken to reduce the margin between the procurement and sale prices. The retail price of wheat is almost double the procurement price. What is the justification for such a high margin?

Even if we accept that higher agricultural prices would lead to general inflation, what is the justification for suppressing the interests of one section (which is the impoverished section) alone? To contain the Indian inflation, what is more urgent is expenditure, cost and price disciplines in non-agricultural sectors than choking off the income of the farm sector.

Many people try to justify the resource transfer from the agricultural to the industrial sector by means of the price drift on the ground that it contributes to resource mobilisation. The argument is that the agricultural sector is undertaxed and hence resource mobilisation should be made by some other device, such as the suppression of prices. The thesis that agriculture is undertaxed is quite wrong (for details, see the author's article, "Is agriculture really undertaxed?" in *Rural India*—October-November 1979).

Further, on what grounds does one justify such arbitrary resource transfers as are taking place through the price divergences? Which economic, social or political principles justify the sugar barons, rubber industrialists, multinational beverage firms, unscrupulous traders, etc., enriching themselves by squeezing the poor farmers?

Objections have been raised also against certain subsidies granted to the rural sector, such as the subsidy on fertilizers. But, as a matter of fact, the industrial sector of this country is more subsidised than the agricultural. Under the backward area development schemes, even large industrial houses are offered a number of subsidies.

36

Globalisation

Internationalisation/Globalisation of business has become a subject of very serious discussion in the national economic policies and corporate board rooms. The subject has assumed great significance in the light of the recent changes in the global business environment and the national economic policy changes. In fact, the very first objective of the current Export-Import Policy (1992-'97) of India is *to establish the framework for globalisation of India's foreign trade*.

International trade is growing faster than world output and international investment is growing much faster than the global trade. These are clear indications of the growing internationalisation of business.

The terms internationalisation and globalisation are often used interchangeably even in economic and business discussions. However, they are not, strictly speeking, one and the same. Business with one or more foreign countries amounts to internationalisation. Globalisation means adopting a global outlook for the business and business strategies aimed at enhancing global competitiveness. Companies which have adopted a global outlook "stop thinking of themselves as national marketers who venture abroad and start thinking themselves as global marketers. The top management and staff are involved in the planning of world-wide manufacturing facilities, marketing policies, financial flows and logistical systems. The global operating units report directly to the chief executive or executive committee, not to the head of an international division. Executives are trained in worldwide operations, not just domestic or international. Management is recruited from many countries; components and supplies are purchased where they can be obtained at the least cost; and investments are made where the anticipated returns are the greatest."[1]

---

[1] Philip Kotler, *op cit.* p.

A truly global corporation views the entire world as a single market; it does not differentiate between domestic market and foreign markets. In other words, there is nothing like a home market and international market - there is only one market, i.e., the global market. As Kenichi Ohmae, a world renowned management expert and author, observes[2], a global corporation develops a genuine equidistance of perspective. That is, managers with a truly global orientation consciously try to set plans and build organisations as if they saw all key customers equidistant from the corporate centre. For example, the managers of Honda, which has operations in several parts of the world, do not think or act as if the company were divided between Japanese and overseas operations. Indeed, the very word "overseas" has no place in Honda's vocabulary because the corporation sees itself as equidistant from all its key customers. At Casio, the top managers gather information directly from each of their primary markets and then sit down together once a month to lay out revised plans for global product development.

WHY GO INTERNATIONAL?

There are several answers to the question 'Why firms go international?' The factors which motivate or provoke firms to go international may be broadly divided into two groups, viz., the pull factors and the push factors.

The *pull factors*, most of which are *proactive reasons* are those forces of attraction which pull the business to the foreign markets. In other words, companies are motivated to internationalize because of the attractiveness of the foreign market. Such attractiveness include, broadly, the relative profitability and growth prospect.

The *push factors* refer to the compulsions of the domestic market which prompt companies to internationalise. Most of the push factors are *reactive reasons*.

Profit Advantage

An important incentive for international business is the profit advantage. International business could be more profitable than the domestic. There are cases where more than 100 per cent of the total profit of the company is made in the foreign markets (in which case the domestic operation, obviously, is incurring loss).

Even when international business is less profitable than the domestic, it could increase the total profit if the international business enables the form to achieve optimum capacity utilisation or economies of scale.

One of the important motivations for foreign investment is to reduce the cost of production (by taking advantage of the cheap labour, for example). While in some cases, the whole manufacturing of a product may be carried out in foreign locations; in some cases only certain stages of it are done abroad.

---

[2] Kenichi Ohmae, "Managing in Borderless World," *Harvard Business Review*, May-June, 1989.

Growth Opportunities

The enormous growth potential of many foreign markets is a very strong attraction for foreign companies. In a number of developing countries, both the population and income are growing fast. Naisbitt and Aburdene observe, Asians will be *the* consumers of the 1990's. During the decade 80 million more will be added to the wealthiest Asian countries (versus about 10 million in Europe). That means great opportunities for North Americans and Europeans, as well as for Asian producers.[3]

It may be noted that several developing countries, the newly industrialising countries (NICs) and the Peoples' Republic of China in particular, have been growing much faster than the developed countries.

Even if the market for several goods in these countries is not very substantial at present, many companies are eager to establish a foothold there, considering their future potential.

Domestic Market Constraints

Domestic demand constraints drive many companies to expanding the market beyond the national border.

The market for a number of products have tended to saturate or decline in the advanced countries. This often happens when the market potential has been almost fully tapped. In the United States, for example, the stock of several consumer durables like Cars, TV sets etc. exceed the total number of households. Estimates are that in the first quarter of the 21st century, while the population in some of the advanced economies would saturate or would grow very negligibily, in some others there would be a decline. Such demographic trends have very adverse effects on certain lines of business. For example, the fall in the birth rate implies contraction of market for several baby products.

Another type of domestic market constraint arises from the scale economies. The technological advances have increased the size of the optimum scale of operation substantially in many industries making it necessary to have foreign market, in addition to the domestic market, to take advantage of the scale economies. It is the thrust given to exports that enabled certain countries like South Korea to set up economic size plants. In the absence of foreign markets, domestic market constraint comes in the way of benefiting from the economies of scale in some industries. For example, for a certain chemical product, the minimum economic size of the plant is

---

[3] Naisbitt and Aburdene, *op.cit.*, p. 11.

35,000 tonnes but the demand for it in India by the end of the century is expected to be less than 10,000 tonnes.

Particularly when the domestic market is very small, internationalisation is the only way to achieve significant growth. For example, *Nestle* derives only about two per cent of its total sales from its home market, Switzerland. Similarly with only 8 per cent of the total sales coming from the home market, Holland, many different national subsidiaries of the *Philips* have contributed much larger share of total revenues than the parent company.

International business may help a firm to mitigate the effects of domestic recession.

Competition

Competition may become a driving force behind internationalisation. A protected market does not normally motivate companies to seek business outside the home market. Until the liberalisations which started in July 1991, the Indian economy was a highly protected market. Not only that the domestic producers were protected from foreign competition but also domestic competition was restricted by several policy induced entry barriers, operated by such measures as industrial licensing and the MRTP regulations. Being in a sellers market, the Indian companies, in general, did not take the foreign market seriously. The economic liberalisations, ushered in India since 1991, which have increased competition from foreign firms as well as from those within the country, have, however, significantly changed the scene. Many Indian companies are now systematically planning to go international in a big way.

Many companies also take an offensive international competitive strategy by way of *counter-competition*.

The strategy of counter-competition is to penetrate the home market of the potential foreign competitor so as to diminish its competitive strength and to protect the domestic market share from foreign penetration. "Effective counter-competition has a destabilising impact on the foreign company's cash flows, product related competitiveness and decision making about integration. Direct market penetration can drain vital cash flows from the foreign company's domestic operations. This drain can result in lost opportunities, reduced income, and limited production, imparing the competitor's ability to make overseas thrusts."[4]

Government Policies and Regulations

Government policies and regulations may also motivate internationalisation. There are both positive and negative factors which could cause internationalisation.

---

[4] Craig Watson, "Counter-competition abroad to protect home markets", *Harvard Business Review*, January-February, 1982, p. 41.

Many governments give a number of incentives and other positive support to domestic companies to export and to invest in foreign countries. Similarly several countries give a lot of importance to import development and foreign investment.

Sometimes, as was the case in India, companies may be obliged to earn foreign exchange to finance their imports and to meet certain other foreign exchange requirements like payment of royalty, dividend, etc. Further, in India, permission to enter certain industries by the large companies and foreign companies was subject to specific export obligation.

Some companies also move to foreign countries because of certain regulations, like the environmental laws in advanced countries.

Spin-off Benefits

International business has certain spin-off benefits too.

International business may help the company to improve its domestic business; international business helps improve the image of the company.

Further, the foreign exchange earnings may enable a company to import capital goods, technology etc. which may not otherwise be possible in countries like India.

Another attraction of exports is the economic incentives offered by the government.

Strategic Vision

The systematic and growing internationalisation of many companies is essentially a part of their business policy or strategic management. The stimulus for internationalisation comes from the urge to grow, the need to become competitive, the need to diversify and to gain the strategic advantages of internationalisation. There are a number of corporations which are truly global. Planning of manufacturing facilities, logistical systems, financial flows and marketing policies in such corporations are done considering the entire world as its, and a single market — a borderless world.

INTERNATIONALISATION STRATEGIES

There are a number of strategies for internationalisation/globalisation of business. These strategies are sometimes referred to as foreign market entry strategies.

Each of these strategies has certain advantages and disadvantages. A strategy very appropriate for a particular market may not be very suitable for another market with different business environment. Therefore, it is not uncommon that a company employs different strategies for different markets.

A brief account of the different strategies are given below.

Exporting

Exporting, the most traditional way of doing business internationally, is very common even today.

Exporting is attractive than other methods particularly when underutilised capacity exists. Again, it is attractive when the cost of production in the home country is substantially lower than producing the goods in the foreign markets.

A company may not like to invest in production facilities in a foreign country because of the political or commercial risks.

The alternatives to making investment in foreign countries by the international marketer for making the goods in the foreign countries are licensing and contract manufacturing. Although these have certain advantages, there are also certain risks. Hence, if a company does not want to invest in a foreign country and if it does not also want to go in for licensing or contract manufacturing, the only avenue open is exporting.

Although exporting may turn out to be the best alternative under a given set of conditions or environmental factors, there are several sets of conditions which make exporting less attractive than one or more of other alternatives. Policies of some foreign governments discriminate against imports; in some cases import is even banned. It may be noted that hostility against imports have been encouraging substitution of exports by production in the foreign markets. A number of foreign companies have set up production facilities in the European community to overcome the *Fortress 92*. Japanese transplants in North America have also been caused to considerable extent by the hostility towards imports.

Besides, in a number of cases cost considerations make foreign production or assembly preferable to exporting.

Although exporting has disadvantages or limitations in a number of situations, there are several situations which make exporting preferable to other entry strategies. Further, as noted in the introductory chapter, exporting marks the first stage in the evolution of international business of many companies. As the international business grows/to expand the business or as the environment changes, it may become necessary to change the strategies stage in the evolution of international business of many companies. As the international business grows/the business or as the environment changes, or to expand the business, it may become necessary to change the strategies.

Ways of Exporting

There are, broadly, two ways of exporting, viz., *indirect* exporting and *direct* exporting.

---

5. Gorden E. Miracle and Gerald Albaum, *International Marketing Management* (Homewood: Richard D. Irwin Inc., 1970), p. 327.

These two basic forms of exporting are distinguished on the basis of how the exporter carries out the transactions flow between himself and the foreign importer or buyer. In indirect export, the manufacturer utilises the services of various types of independent international marketing middlemen or co-operative organisations. In other words, when a manufacturer exports indirectly, he transfers the responsibility for the selling job to some other organisation. On the other hand, in direct export, the responsibility for performing international selling activities rests on the producer. These activities are carried out by so-called dependent organisations that are administratively a part of the manufacturer's company organisation.[5]

The indirect export is more popular with firms which are just beginning their exporting and with those whose export business is small.

The major advantage of indirect exporting is that a firm does not have to build up the infrastructure required for exporting and it does not have to bear the risks associated with it. The indirect way is therefore often regarded as especially advantageous for firms with small means and for those whose limited export business does not justify large investments in developing their own international marketing infrastructure.

The main disadvantage of indirect exporting is that the manufacturer does not have any direct contact with the foreign importer or customer and that he is often at the mercy of the middlemen. This may affect the prospects of the manufacturer to develop an enduring international business. Exporters who have a permanent interest in the international market and those who want to expand the international business would, therefore, tend to turn to direct exporting.

Many small Indian exporters are indirect exporters who export through merchant exporters (including export/trading houses) and agents.

As the term indicates, direct export refers to the sale in the foreign market directly by the manufacturer. The manufacturer may make the sale directly to the foreign customers or to a middleman or middlemen located in the overseas market. In both the cases, the export is direct — the manufacturer does not use any independent middleman in the channel between the home country and the overseas market.

Licensing and Franchising

Licensing and Franchising, which involve minimal commitment of resources and effort on the part of the international marketer, are easy ways of entering the foreign markets.

Under international licensing, a firm in one country (the licensor) permits a firm in another country (the licensee) to use its intellectual property (such as patents, trade marks, copyrights, technology, technical know-how, marketing skill or some other specific skill). The monetary benefit to the licensor is the royalty or fees which the licensee pays.

In many countries, such fees or royalties are regulated by the government, it does not exceed five per cent of the sales is many developing countries.

A licensing agreement may also be one of *cross licensing* wherein there is a mutual exchange of knowledge and/or patents. In cross-licensing, a cash payment may or may not be involved.

Franchising is "a form of licensing in which a parent company (the franchisor) grants another independent entity (the franchisee) the right to do business in a prescribed manner. This right can take the form of selling the franchisor's products, using its name, production and marketing techniques, or general business approach."[6] One of the common forms of franchising involves the franchisor supplying an important ingredient (part, material etc.) for the finished product, like the *Coca Cola* supplying the syrup to the bottlers.

Usually franchising involves a combination of many of the elements mentioned above. The major forms of franchising are manufacturer — retailer systems (such as automobile dealership), manufacturer — wholesaler systems (such as soft drink companies), and service firm — retailer systems (such a lodging services and fast food outlets).[7]

One of the growing trends recently had been *trademark licensing*. Czinkota and Ronkainen point out that trademark licensing has become a substantial source of worldwide revenue. The total volume of trademark licensing was expected to reach $ 75 billion by 1990. The names or logos of designers, literary characters, sports teams, and movie stars appear on clothing, games, foods and beverages, gifts and novelties, toys and home furnishings.[8]

A number of foreign companies have entered the Indian market, both industrial and consumer goods, by licensing.

The Walt Disney Company, U.S.A., the world famous entertainment company, is entering the Indian market by licensing through a joint venture with the Modis. The joint venture would be licensed by Walt Disney to market products developed by the latter using its popular characters, concepts and ideas. The joint venture would bring to India a whole range of Walt Disney products including films, music cassettes, toys, videos and educational aids. The entry of Walt Disney would put a stop to the infringement of the company's copyrights on its characters by domestic manufacturers. A large number of local manufacturers in India have been using Walt Disney characters to popularise their products without paying any royalty for their use.

---

[6] Donald W. Hackett, "The International Expansion of U.S. Franchise System" in Warren J. Keegan and Charles S. Mayer (eds.), *Multinational Product Management* (Chicago: American Marketing Association, 1929), pp. 61-81, cited by Czinkota and Ronkainen, *op.cit.*, pp. 392-3.

[7] Czinkota and Ronakainen, *International Marketing* (Chicago : The Dryden Press, 1990), p. 393.

[8] *Ibid.*, p. 392.

Licensing has been used by many companies also to harvest their obsolete products. This strategy has been employed, in particular, in developing countries.

When the market is closed by the host country regulations either to imports or to foreign investment, licensing may provide a viable opportunity to enter such a market.

From the point of view of the licensee, licensing provides the great advantage of entering the market with a proven product/technology or marketing intangible without having to run the risk of R & D failures. It also reduces the investment requirements concluded between the U.S. and Japanese firms for transfer of T.V. technology to Japan. Firms in several other industries also licensed their technology etc. to foreign firms. But several of them were shocked to learn that they had grossly underestimated the vast potential of the foreign markets. For example, one U.S. firm that licensed an English firm to manufacture and sell its products in the United Kingdom, but agreed to give the English firm an exclusive right to sublicense the U.S. expertise in other countries, for it then had no marketing commitment to exports. Within a few years, global markets developed for the company's products, and was stuck with another party getting the benefits. Another U.S. firm, a drug manufacturer, gave an Asian company a manufacturing license. The Asian Market, which upto then had seen nothing at all, boomed, leaving the U.S. firm as almost an outsider.[9]

One of the important risks of licensing is that the licensor would be developing a potential competitor; the licensee would become a competitor after the expiry of the licensing agreement.

Contract Manufacturing

Under contract manufacturing, a company doing international marketing contracts with firms in foreign countries to manufacture or assemble the products while retaining the responsibility of marketing the product. This is a common practice in international business. There are a number of multinationals and affiliates of multinationlas which employ this strategy in India in respect of some of the products they market, like Park Davis, Hindustan Lever, Ponds etc.

Contract manufacturing has the following advantages:

---

[9] These cases which were cited by David A Ricks, *Big Business Blunders: Mistakes in Multinational Marketing* (Homewood: Dow Jones Irwin, 1983) have been reproduced by Henry Ferguson, *Tommorrow's Global Executive* (New Delhi: Universal Book Stall, 1989), p. 30.

(i) The company does not have to commit resource for setting up production facilities.

(ii) It frees the company from the risks of investing in foreign countries.

(iii) If idle production capacity is readily available in the foreign country, it enables the marketer to get started immediately.

(iv) In many cases, the cost of the product obtained by contract manufacturing is lower than if it were manufactured by the international firm. For example, the product cost in the small scale sector is much lower than in the large scale sector for many products because of the lower wages, lower overheads, and tax concessions. Moreover, if excess capacities are available with existing units, it may even be possible to get the product supplied on the marginal cost basis.

(v) Contract manufacturing also has the advantage that it is a less risky way to start with. If the business does not pick up sufficiently, dropping it is easy; but if the company had established its own production facilities, the exist would be difficult. It may be interesting to note that the availability of excess capacity with some soap manufacturers enables several foreign companies to experiment with new brands of toilet soap in the Indian market. For example, Godrej Soaps manufactured Dettol for Reckitt and Coleman; Clearton for Nicholas Laboratories; Johnson's Baby Soap for Johnson and Johnson; and Pond's Dreamflower, Cold Cream and Sandalwood for Pond's. It may be noted that some of these brands have not succeeded in the market. The cost to the company of the product failure is relatively low when it did not invest in production facilities.

Contract manufacturing, however, has the following disadvantages:

(i) In some cases, there will be the loss of potential profits from manufacturing.

(ii) Less control over the manufacturing process.

(iii) Contract manufacturing also has the risk of developing potential competitors.

(iv) It would not be suitable in cases of high-tech products and cases which involve technical secrets etc.

Management Contracting

Under the management contract, the international firm supplies management know-how for a company in the foreign country. For example, Harrisons Malayalam Ltd., India, has recently entered into an agreement for management of some plantations in Sri Lanka.

Under the management contract, the firm providing the management know-how may not have any equity stake in the enterprise being managed. In short, "in a management contract the supplier brings together a package of skills that will provide an integrated service to the client without incurring the risk and benefit of ownership."[10] Thus, as Kotler obeserves, "management contracting is a low-risk method of getting into a foreign market and it starts yielding income right from the beginning. The arrangement is especially attractive if the contracting firm is given an option to purchase some shares in the managed company within a stated period."[11]

Management contracts, obviously, have clear benefits for the clients. "They can provide organisational skills not available locally, expertise that is immediately available rather than built up, and management assistance in the form of support services that would be difficult and costly to replicate locally."[12] Turn-key contracts are also management contracts.

Management contracts have disadvantages under certain conditions. As Kotler observes, the arrangement " is not sensible if the company can put its scarce management talent to better use, or if there are greater profits to be made by undertaking the whole venture. Management Contract may prevent a company from setting up its own operations for a particular period."[13]

One possible risk from the point of view of the client is overdependence and loss of control. The client should enable itself to steadily develop its own capabilities.

Fully Owned Manufacturing Facilities

Companies with long term and substantial interest in the foreign market normally establish fully owned manufacturing facilities there. As Drucker points out, "it is simply not possible to maintain substantial market standing in an important area unless one has a physical presence as a producer."[14]

A number of factors like trade barriers, differences in the production and other costs, government policies etc. encourage the establishment of production facilities in the foreign markets. More information about this is provided in the chapter on *foreign investment*.

Establishment of manufacturing facilities abroad has several advantages. It provides the firm with complete control over production and quality.

---

[10] *Ibid*., p. 492.

[11] Philip Kotler, *Principles of Marketing* (New Delhi: Prentice Hall of India Pvt. Ltd., 1987), p. 666.

[12] Czinkota and Ronkainen, *op. cit*., p. 493.

[13] Kotler, *op. cit*., p. 666.

[14] Peter F Drucker, *Managing for the Future*, *op. cit*., p. 30.

It does not have the risk of developing potential competitors as in the case of licensing and contract manufacturing.

Wholly owned manufacturing facility has several disadvantages too.

In some cases, the cost of production is high in the foreign market. There may also be problems such as restrictions regarding the type of technology, non-availability of skilled labour, production bottlenecks due to infrastructural problems etc. If the market size is small, a separate production unit for the market may be uneconomical. Foreign investment also entails political risks.

Fully owned enterprises may not be allowed or favoured in some countries, particularly in low priority areas.

Moreover, this method demand sufficient financial and managerial resources on the part of the company.

Assembly Operations

As Miracle and Albaum point out, a manufacturer who wants many of the advantages that are associated with overseas manufacturing facilities in selected markets. In a sense, the establishment of an assembly operation represents a cross between exporting and overseas manufacturing.[15]

Having assembly facilities in foreign markets is very ideal when there are economies of scale in the manufacture of parts and components and when assembly operations are labour intensive and labour is cheap in the foreign country. It may be noted that a number of U.S. manufacturers ship the parts and components to the developing countries, get the product assembled there and bring it back to U.S. The U.S. tariff law also encourages this. Thus, even products meant to be marketed domestically are assembled abroad.

Assembling the product meant for the foreign market in the foreign market itself has certain other advantages, besides the cost advantage. The import duty is normally low on parts and components than on the finished product. Assembly operations would satisfy the 'Local content' demand, at least to some extent. Because of the employment generation, the foreign government's attitude will be more favourable than towards the import of the finished product.

Another advantage is that the investment to be made in the foreign country is very small in comparison with that required for establishing complete manufacturing facilities. The political risks of foreign investment is, thus, not much.

Joint Ventures

Joint venture is a very common strategy of entering the foreign market.

---

[15] Miracle and Albaum, *op.cit.*, p. 380.

In the widest sense, any form of association which implies collaboration for more than a transitory period is a joint venture (pure trading operations are not included in this concept.) Such a broad definition encompasses many diverse types of joint overseas operations, viz.

(i) Sharing of ownership and management in an enterprise.
(ii) Licensing agreements.
(iii) Contract manufacturing.
(iv) Management contracts.

Three of the above have already been discussed in the preceding sections. The following paragraphs are confined to the first category referred to above, i.e., joint ownership ventures. What is often meant by the term joint venture is joint ownership venture. Details were given in a preceding section.

Mergers and Acquisitions

Mergers and Acquisitions (M & As) has been a very important market entry strategy as well as expansion strategy. In the second half of the 1980s, particularly, Japanese companies have made massive M & As in the U.S. and Europe. Companies of some other Asian countries, like Korea and Taiwan, also made significant corporate raids in these countries. According to one estimate, in just 32 months between January 1987 and August 1989, the investments of Japanese and other Asian companies through corporate M & As soared to $ 27 billion bringing 320 odd companies under their thumb.[16]

Another important objective of M and A is to obtain access to new technology or a patent right.

M and A also has the advantage of reducing the competition.

Mergers and acquisitions may also give rise to some problems which arise mostly because of the deficiencies of the evaluation of the case for acquisition. Sometimes the cost of acquisition may be unrealistically high. Further, when an enterprise is takenover, all its problems are also acquired with it. The success of the enterprise will naturally depend on the success in solving the problems.

It has also been observed that the takeover spree lands several companies in trouble. For example, in the early 1990s a number of Japanese companies began to sell some of the foreign businesses which they had acquired a few years ago. The main reason for this was the financial crunch.

Strategic Alliance

Strategic alliance has been becoming more and more popular in international business. Also known by such names as *entente* and *coalition,* this strategy seeks to enhance the long term competitive advantage of the firm by forming alliance with its competitors, existing or potential in critical areas, instead of competing with each other. "The goals are to leverage critical capabilities, increase the flow of innovation and increase flexibility in responding to market and technological changes."[17]

---

[16] Tan Lee Hock, " Asian Corporate Tigers Raid the Western Front," *Asian Finance*, 15 October 1989, p. 28.

Strategic alliance is also sometimes used as a market entry strategy. For example, a firm may enter a foreign market by forming an alliance with a firm in the foreign market for marketing or distributing the former's products. A U.S. pharmaceutical firm may use the sales promotion and distribution infrastructure of a Japanese pharmaceutical firm to sell its products in Japan. In return, the Japanese firm can use the same strategy for the sale of its products in the U.S. market.

A strategic alliance between the U.S. multinational Procter and Gamble (P & G) and the Indian company Godrej Soaps Ltd. has given birth to joint venture company called P & G Godrej(P & GG) to market the toilet soaps, detergents and cleansing and personal care products of both P and G and Godrej Soaps. The alliance provides P and G with the advantage of large access to the Indian market through the well established distribution network of Godrej Soaps. Godrej Soaps would benefit from the R and D and technological strength of P and G. P and G can utilise the manufacturing base of Godrej which is equally comparable with those of P & G worldwide to manufacture P & G brands like *Camay, Ivory, Zest* etc. The alliance also enables both the parties to fight the competition more effectively.

In short, strategic alliance have been rapidly increasing, particularly in the international business. They are not confined entirely to large firms. As indicated earlier, several factors like high risks and costs of R and D; fast changes and complexities of technology and the resultant imbalance in the house technical capabilities; high cost of marketing; the need to acquire complementary technology and skills, need to achieve economies of scale of cost effectiveness through other ways such as outside sourcing; need to overcome market entry barriers, etc. make alliance, instead of competition, the best competitive strategy.

Countertrade

Although the major reason for the substantial growth of countertrade is its use as a strategy to increase exports, particularly by the developing countries, countertrade has been unsuccessfully used by a number of companies as an entry strategy. For example, Pepsico gained entry to the USSR by employing this strategy.

---

[17] Czinkota and Ronckainer, *op. cit.*, p. 491.

Countertrade is a form of international trade in which certain export and import transactions are directly linked with each other and in which import of goods are paid for by export of goods, instead of money payments.

In the modern economies, most transactions involve monetary payments and receipts, either immediate or deferred. As against this, "countertrade refers to a variety of unconventional international trade practices which link exchange of goods — directly or indirectly — in an attempt to dispense with currency transactions."[18]

A considerable share of the international trade is covered by countertrade. By mid 1980s, there were about 90 countries practicing countertrade. In the early 1980s countertrade covered nearly 38 per cent of East-West trade.

Forms of Countertrade

Countertrade takes several forms. The following are the most common among them:

Barter: Barter refers to direct exchange of goods of equal value, with no money and no third party involved in it. For example, a countertrade deal between the Minerals and Metals Trading Corporation of India (MMTC) and a Yugoslavian company involved import of 50,000 tonnes of rails of the value of about $ 38 million by the MMTC and the purchase by the Yugoslavian company of iron ore concentrates and pellets of the same value.

Buy Back: Under the buy back agreement the supplier of plant, equipment or technology agrees to purchase goods manufactured with that equipment or technology. Under the buy back scheme, the full payment may be made in kind or a part may be made in kind and the balance in cash. Thus, a Rs. 20 crore buy back agreement with the Soviet Union provided for the import of 200 sophisticated looms by the National Textiles Corporation. They buy back ratio was 75 per cent.

Compensation Deal: Under this arrangement, the seller receives a part of the payment in cash and the rest in products.

Counterpurchase: Under the counterpurchase agreement the seller receives the full payment in cash but agrees to spend an equivalent amount of money in that country within a specified period. A classic example of this kind of an agreement is Pepsi Cola's trade with the USSR. Pepsi Cola got paid in Rubles for the sale of its concentrates in the USSR but spent this amount for purchase of Russian products like Vodka and wine.

---

[18] Bruce Fitzgerald, " Countertrade Reconsidered," *Finance and Development*, June 1987, p. 46.

* For a detailed account of the countertrade see Francis Cherunilam, *International Trade and Export Management* (recent edition), Himalaya Publishing House, Bombay.

GLOBALISATION OF INDIAN BUSINESS

India's international business has been confined mostly to exports. Although some developing countries like S. Korea and Taiwan, whose economic position had not been better than that of India when India started planned development, have made substantial investments in other countries. Indian companies have not made any significant foreign investment so far. Although Government of India's policy has been one of encouraging foreign investment by Indian companies, subject to certain conditions, several factors like the domestic economic policy and the domestic economic situation have been deterrents to foreign investment by Indian companies.

By restricting the areas of operation and growth, the government policy seriously constrained the potential of Indian companies to make a foray into the foreign countries through investment. Added to this was the attraction of the protected domestic market which was, in many cases, a seller's market which made the Indian companies to ignore the foreign markets.

The new economic policy of India is expected to encourage the internationalisation of Indian business. The increasing domestic competition is compelling many companies to pursue internationalisation vigorously. The liberalisation of policy towards foreign technology and collaborations is enabling Indian companies to upgrade their production facilities or to establish new facilities which help them enter/expand the foreign market. A number of companies have thus increased their foreign business.

A number of Indian companies are also setting up units abroad, either alone or in collaboration with foreign firms.

Indian companies have also been acquiring firms in foreign countries.

More and more Indian firms have been taking advantage of the international sourcing by becoming suppliers of parts and components to companies abroad. For example, the recent recession in the Indian automobile industry has encouraged several component manufacturers to seek buyers abroad.

Technological and marketing tie-ups with foreign firms will play a major role in internationalisation of the Indian business. While many foreign firms are interested in such collaborations for sourcing supplies for the foreign markets, many other foreign firms would like to have such collaborations for business in both the Indian and foreign markets.

Indian business, however, encounters the following problems in internationalisation.

(1) Policy and procedural problems.

(2) Infrastructural bottlenecks.

(3) Resource constraints.

(4) High domestic costs.

(5) Lack of experience in managing business abroad.

(6) Limited R and D and marketing research.

Although a number of companies are planning to substantially expand their international business, a true global orientation is yet to set in.

37

Foreign Capital and Technology

Most of the countries have been making use of foreign capital and technology to accelerate the pace of their economic growth. There is hardly any advanced country the development of which was not assisted by foreign capital or technology. It is interesting to note that foreign capital and technology are to play a very important role in economic rejuvenation of Eastern Europe, Russia etc. It is quite sometime since China began to receive foreign capital and technology in a big way.

India being a developing country, the importance of foreign capital and technology needs no emphasis. The domestic savings available for investment being small, foreign capital can help augment the productive capacity of the nation. While it is true that in the last four decades we have made significant progress in the field of science and technology, we still lag behind in a number of cases. In today's dynamic world, even a developed country can be hardly self-sufficient and most up-to-date in all spheres of technology.

TYPES OF FOREIGN INVESTMENT

Broadly there are two types of foreign investment, namely, foreign direct investment (FDI) and portfolio investment.

FDI refers to investment in a foreign country where the investor retains control over the investment. It typically takes the form of starting a subsidiary, acquiring a stake in an existing firm or starting a joint venture in the foreign country. Direct investment and management of the firm concerned normally go together.

If the investor has only a sort of property interest in investing the capital in buying equities, bonds, or other securities abroad, it is referred to as portfolio investment. That is, in the case of portfolio investments, the investor uses his capital inorder to get a return on it, but has no much control over the use of the capital.

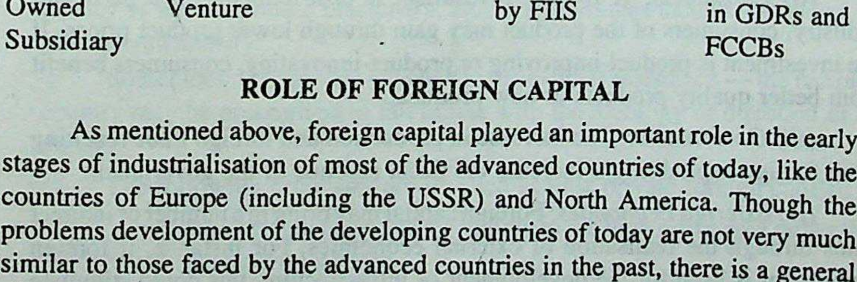
FDIs are governed by long term considerations because these investments cannot be easily liquidated. Hence, factors like long term political stability, government policy, industrial and economic prospects etc., influence the FDI decision. However, portfolio investments which can be liquidated fairly easily are influenced by short term gains. Portfolio investments are generally much more sensitive than FDIs. Direct investors have direct responsibility associated with the promotion and management of the enterprise. Portfolio investors do not have such involvement with the promotion and management.

Since the economic liberalisation of 1991, there has been a surge in the FDI and portfolio investments in India (Also see the last chapter).

There are mainly two routes of portfolio investments in India, viz., by Foreign Institutional Investors (FIIs) like mutual funds and through global Depository Receipts (GDRs) and Foreign Currency Convertible Bonds (FCCBs).

GDRs and FCCBs are instruments issued by Indian companies in the Euro markets for mobilising foreign capital by facilitating portfolio investment by foreigners in Indian securities. Since 1992, Indian companies, satisfying certain conditions, are allowed to access foreign capital markets by Euro issues.

With reference to foreign investment in India, foreign investment may be classified as follows:



ROLE OF FOREIGN CAPITAL

As mentioned above, foreign capital played an important role in the early stages of industrialisation of most of the advanced countries of today, like the countries of Europe (including the USSR) and North America. Though the problems development of the developing countries of today are not very much similar to those faced by the advanced countries in the past, there is a general view that foreign capital, if properly directed and utilised, can assist the development of the developing countries.

Economic growth is a function of, among other things, capital formation. In the developing countries, the *per capita* income and savings rate being very low, domestic capital formation is inadequate to give a 'big push' to the economy to take it to the 'take-off' stage. Hence, the domestic resources may be supplemented with foreign capital to achieve the critical minimum investment to break the vicious circle of 'low income-low savings-low investment-low income.'

Another way by which foreign capital helps accelerate the pace of economic growth is by facilitating essential imports required for carrying out development programmes, like capital goods, know-how, raw materials and other inputs and even consumer goods. The machinery, know-how and other inputs needed may not be indigenously available. Further, the demand spurt created by large-scale investments may necessitate import of consumer goods. When the export earnings are insufficient to finance such vital imports, foreign capital should help reduce the foreign exchange gap.

Foreign investments may also help increase a country's export and reduce the import requirements if such investments take place in export-oriented and import-competing industries.

Following the analysis of Donald MacDougall and Paul Streeten, Gerald Meier observes[1] that, from the standpoint of national economic benefit, the essence of the case for encouraging an inflow of capital is that the increase in real income resulting from the act of investment is greater than the resultant increase in the income of the investor. If the value added to output by the foreign capital is greater than the amount appropriated by the investor, social returns exceed private returns. As long as foreign investment raises productivity, and this increase is not wholly appropriated by the investor, the greater product must be shared with others, and there must be some direct benefits to other income groups as mentioned below:

(i) Domestic Labour: Domestic labour may get higher real wages because of the increase in productivity. There might also be an expansion of the employment opportunities.

(ii) Consumers: If foreign investment is cost-reducing in a particular industry, consumers of the product may gain through lower product prices. If the investment is product-improving or product-innovating, consumers benefit from better quality products or new products.

(iii) Government: The increase in production and foreign trade resulting from foreign capital might increase the fiscal revenue of the government.

(iv) External Economies: Foreign capital may bring in a number of indirect gains through the realisation of external economies. For instance, if foreign investment is used for the development of infrastructure, this could stimulate domestic investment in industrial and other sectors.

---

[1] Gerald M. Meier, "Benefits and Costs of Private Foreign Investment" in *Leading Issues in Economic Development, op. cit.*, pp. 296-308.

Further advantages of foreign capital are mentioned under 'Private Foreign Capital.'

Private Foreign Capital

Private foreign capital mostly takes the form of direct investment. Hence, we deal here with the direct foreign investment (private). The important advantages of direct foreign investment are the following:

1. It helps increase the investment level and thereby the income and employment in the host country.
2. Direct foreign investment facilities transfer of technology to the recipient country.
3. It may kindle managerial revolution in the recipient country through professional management and the employment of highly sophisticated management techniques.
4. Foreign capital may enable the country to increase its exports and reduce import requirements.
5. Foreign investments may stimulate domestic enterprise because to support their own operations, the foreign investors may encourage and assist domestic suppliers and consuming industries.
6. Foreign investment may also help increase competition and break domestic monopolies.

Limitations and Dangers of Foreign Capital

Foreign capital, both private and official (governmental and institutional), have certain limitations. Certain additional risks are associated with the private foreign capital.

One of the important limitations to utilise the foreign capital is the absorptive capacity of the recipient country, i.e., the capacity of the country to utilise the foreign capital effectively. Lack of infrastructural facilities, technical know-how, personnel, inputs, market, feasible projects, inefficiency or inadequacy of administrative machinery, etc., are important factors that affect the absorptive capacity.

Sometimes 'strings' are attached to the official assistance — the recipient country may be pressurised to fall in line with the ideology or direction of the donor.

The following criticisms are levelled against private foreign capital:

1. Private foreign capital tends to flow to the high profit area rather than to the priority sectors.
2. The technologies brought in by the foreign investor may not be adapted to the consumption needs, size of the domestic market, resource availabilities, stage of development of the economy, etc.

3. Through their power and flexibility, the multinational corporations can evade or undermine economic autonomy and control, and their activities may be inimical to the national interest of particular countries.
4. Foreign investments, sometimes, have unfavourable effect on the Balance of Payments of a country because the drain of foreign exchange by way of royalty, dividend, etc., is more than the investment made by the foreign concern.
5. Foreign capital sometimes interferes in the national politics.
6. Foreign investors sometimes engage in unfair and unethical trade practices.

GOVERNMENT POLICY

India was following a very restrictive policy towards foreign capital and technology. Foreign collaboration was permitted only in fields of high priority and in areas where the import of foreign technology was considered necessary. In other areas, import of technology was considered on merits if substantial exports were guaranteed over a period of 5 to 10 years and if there were reasonable prospects for such exports. The government had issued lists of industries where:

(i) (a) foreign investment may be permitted;
    (b) only foreign technical collaboration (but no foreign investment) may be permitted; and
(ii) no foreign collaboration (financial or technical) was considered necessary.

The government policy on foreign equity participation was thus selective. Such participation had to be justified, having regard to factors such as the priority of industry, the nature of technology involved, whether it would promote exports which might not otherwise take place and the alternative terms available for securing the same or similar technological transfer. Foreign equity participation was limited to 40%, although exceptions were allowed on merit. The foreign share capital was to be by way of cash without being linked to tied imports of machinery and equipment or to payments for knowhow, trade marks, brand names etc.

Technical collaborations were to be considered on the basis of annual royalty payments which were linked with the value of actual production. The percentage of royalty was dependent on the nature of technology. Wherever possible, the payment of fixed amount of royalty per unit of production was preferred. Royalty payments were limited to a period of 5 years.

The Foreign Exchange Regulation Act (FERA), 1973, served as a tool for implementing the national policy on foreign private investment in India. The FERA empowered the Reserve Bank of India to regulate or exercise direct control over the activities of foreign companies and foreign nationals in India. Foreign company was defined as one (other than banking company) which was not incorporated in India or in which non-resident interest was more than 40% or any branch of such company.

According to the FERA, non-resident (including Indian citizens), foreign citizens resident in India and foreign companies required the permission of the RBI to accept appointment as agents or technical management advisers in India of any person or company, or permit the use of their trade marks.

The trading, commercial and industrial activities in India of persons resident abroad, foreign citizens in India and foreign companies were regulated by the FERA. They had to obtain permission from the RBI for carrying on in India any activity of a trading, commercial or industrial nature; opening branches/offices or other places of business in India; acquiring any business undertaking in India; and purchasing share of Indian companies.

RBI had given general permission for certain matters. For example, general permission was granted to foreign companies to acquire or hold any immovable property in India which was necessary for or incidental to, any activity undertaken by them with the permission of the RBI.

The New Policy

The Industrial policy statement of July 24, 1991, which observes that while freeing the Indian economy from official controls, opportunities for promoting foreign investment in India, should also be fully exploited, has liberalised the Indian policy towards foreign investment and technology. The policy statement regards as follows:

"In view of the significant development of the economy in the last 40 years, the general resilience, size and level of sophistication achieved, and the significant changes that have also taken place in the world industrial economy. The relationship between domestic and foreign industry needs to be much more dynamic than it has been in the past in terms of both technology and investment."

"Foreign investment would bring attendant advantages of technology transfer, marketing expertise, introduction of modern managerial techniques and new technologies for promotion of exports."

"This is particularly necessary in the changing global scenario of industrial and economic cooperation marked by mobility of capital. The government will therefore welcome foreign investment which is in the interest of the country's industrial development."

"Promotion of exports of Indian products calls for a systematic exploration of world markets possible only through intensive and highly professional marketing activities."

"To the extent that expertise of this nature is not well developed so far in India, government will encourage foreign trading companies to assist in our export activities. Attraction of substantial investment and access to high technology, often closely held, and to world markets, involves interaction with some of the world's largest international manufacturing and marketing firms.

"There is a great need for promoting an industrial environment where the acquisition of technological capability receives priority."

"In the fast changing world technology, the relationship between the suppliers and users of technology must be a continuous one. Such a relationship becomes difficult to achieve where the approval process includes unnecessary governmental interference on a case to case basis involving endemic delays and fostering uncertainty."

"The Indian entrepreneur has now come of age so that he no longer needs such bureaucratic clearances of his commercial technology relationships with foreign technology suppliers. Indian industry can scarcely be competitive with the rest of the world if it is to operate within such a regulatory environment."

Therefore, with a view to injecting the desired level of technological dynamism in Indian industry, the policy provides for automatic approval for technology agreements related to high priority industries within specified parameters. 51% foreign equity is also allowed in these industries. 35 industries have been specified in the category. Similar facilities will be available for other industries as well if such agreements do not require the expenditure of free foreign exchange.

It may be noted that earlier foreign equity participation was restricted normally to 40% and foreign investment and technology agreements needed prior approval.

The new policy has also made the import of capital goods automatic provided the foreign exchange requirement for such import is ensured through foreign equity.

The Reserve Bank of India (RBI) has announced changes in the policy towards NRI* investments. Accordingly, non-resident Indian and Overseas Corporate Bodies (OCBs) predominantly owned by NRIs can acquire shares/debentures of Indian companies, listed on the stock exchange, upto 24% of their paid up capital under the Portfolio Investment Scheme as against the earlier ceiling of 5%, provided the Indian company so resolves through the general body resolution.

In further relaxation of the policy, on 25th October, the Government announced its decision to allow direct foreign investment by non-resident Indians (NRIs) upto 100% of the equity in 34 industries figuring in *Annexure III* of the new industrial policy. (These are industries where direct foreign investment upto 51% of the equity are allowed). There will be automatic clearance for such investment proposals from NRIs subject to the condition that the project's capital goods imports would be met from the foreign equity. In other words, the Reserve Bank of India will directly handle such applications and clear them.

---

* A non-resident Indian may be:

(a) an Indian citizen:
    (i) who has made his permanent home outside India, or
    (ii) has proceeded abroad for employment or gainful occupation; or
(b) (i) an Indian citizen who made his permanent home outside India and acquired foreign citizenship, or
    (ii) the decendent of an Indian who had earlier migrated from undivided India.

Import of components, raw materials and intermediate goods and payment of knowhow fees and royalties will be governed by the general policy applicable to other domestic units.

The government has also decided to consider applications for direct foreign investment by NRIs upto 100% in areas other than the 34 items mentioned in *Annexure III* of the industrial policy. However, there will be no automatic clearance for such proposals.

Even in areas still reserved for the Public Sector (telecommunication, hydrocarbons, coal, railways and postal services) the Government now has a more liberal approach towards private investment, including foreign investment.

In 1994-95, foreign investment was opened for NRI and persons of Indian origin in a wide range of construction and real estate related activities. Foreign investment was also allowed in constructing and operating highways, expressways and bridges on a toll tax system, generating electricity on build-operate own (BOO) basis, telephone services and certain operations in railways on build-operate-lease-transfer BOLT basis. Without prior approvals, foreign investors can now own upto 24 per cent equity in any Indian firm and upto 20 per cent in new private banks.

FII Investments

The Indian stock market was opened up to FII investment in 1992-93 and since then there has been a significant increase in the portfolio investment by FIIs.

The Regulations on Foreign Institutional Investors, which were notified on November 14, 1995, contains various provisions relating to definition of FIIs, eligibility criteria, investment restrictions, procedures of registration and general obligations and responsibilities of FIIs. According to the Regulations, FIIs may invest only in:

(a) Securities in the primary and secondary markets including shares, debentures and warrants of companies listed on a recognised stock exchange in India, and

(b) Units of schemes floated by domestic mutual funds including Unit Trust of India, whether listed on a recognised stock exchange or not.

Joint ventures between a variety of domestic and foreign securities firms have been approved in the stock broking, merchant banking, assets management and other non bank financial services sectors. The overall effect of FII investment and financial joint ventures has been the introduction of international practices and systems to the Indian securities industry.

The number of FIIs registered with the SEBI increased from 10 with a cumulative investment of $ 0.2 million in January 1993 to 331 with a cumulative investment of $ 5.5 billion in April 1996.

A Review and Evaluation

The response of foreign investors to the policy liberalisation has been encouraging. During the period 1991 to 1994, Government approved 5778 foreign collaboration proposals including 2806 foreign equity proposals amounting to Rs. 22,238 crores. More than 80 per cent of these approvals are in priority sectors such as power generation, oil refinery, electrical equipment, chemicals and export related sectors. As a consequence of amendments in FERA and the liberalisation of foreign investment policy, many MNCs have increased their share of the equity in the Indian enterprises. MNCs like IBM and Coca Cola which divegsted in the 1970s have returned to India to avail of the new opportunities.

The total direct foreign investment (DFI) proposals approved during 1991-94 amounted to $ 7.2 billion (Rs. 22,238 crores) against just under $ 1.0 billion (Rs. 1,274 crores), during the whole of the previous decade (1981-90). Portfolio investments, including GDRs, have also risen sharply — it rose from under $ 100 million in 1992-93 to nearly $ 3.5 billion in 1993-94 could be of the same order in 1994-95.

TABLE

Foreign Investment Flows (Actual) by Category

(US $ million)

	1991-92	*1992-93*	*1993-94*	*1994-95*
A. Direct Invest	**150**	**341**	**620**	**1,314**
(a) RBI automatic route	0	42	89	171
(b) SIA/FIPB route	87	238	315	701
(c) NRIs (40% & 100%)	63	61	217	442
B. Portfolio Investment	**8**	**92**	**3,493**	**3,581**
(a) FIIs	0	1	1,195	1,503
(b) Euro equities	0	86	1,463	1,839
(c) Offshore funds & others	9	5	365	239
Total (A + B)	158	433	4,113	4,895

APPENDIX 37.1

ANNEXURE III OF INDUSTRIAL POLICY STATEMENT, JULY 24, 1991

List of industries for automatic approval of foreign technology agreements and for 51 per cent foreign equity approvals.

Metallurgical Industries

1. ferro alloys,
2. castings and forgings,
3. non-ferrous metals and their alloys,
4. sponge iron and pelletisation,
5. large diameter steel welded pipes of over 300 mm diameter and stainless steel pipes,
6. pig iron.

Boilers & Steam Generating Plants Prime Movers (others than electrical generators)

1. industrial turbines,
2. internal combustion engines,
3. alternate energy systems like solar, wind etc. and equipments therefor.
4. gas/hydro/steam turbines upto 60 M W.

Electrical Equipment

1. equipment for transmission and distribution of electricity including power and distribution transformers, power relays, HT-switch gear synchronous condensers.
2. electrical motors,
3. electrical furnaces, industrial furnaces and induction heating equipment,
4. x-ray equipment,
5. electronic equipment, components including subscribers and telecommunication equipment,
6. component wires for manufacture of lead-in wires,
7. hydro/steam/gas generators/generating sets upto 60 M W.
8. generating sets and pumping sets based on internal combustion engines.
9. jelly-filled telecommunication cables,
10. optic fibre,
11. energy efficient lamps and,
12. midget carbon electrodes.

Transportation

1. mechanist sailing vessels up to 10,000 D W T including fishing trawlers.
2. ship ancillaries,
3. (a) commercial vehicles, public transport vehicles, including automotive commercial three-wheeler jeep-type vehicles, industrial locomotives, (b)

automotive two wheelers and three-wheelers, (c) automotive components / spares and ancillaries.

4. shock absorbers for Railway equipment and,
5. brake system for Railway stock and locomotives.

Industrial Machinery

1. industrial machinery and equipment, machine tools and industrial robots and their controls and accessories,
2. jigs, fixtures, tools and dies of specialised types and cross land tooling and,
3. engineering production aids such as cutting and forming tools, patterns and dies and tools.

Agricultural Machinery

1. tractors,
2. self propelled harvester combines,
3. rice transplanters.

Industrial Instruments

1. indicating, recording and regulating devices for pressure, temperature, rate of flow weights levels and the like. Scientific and electromedical instruments and laboratory equipment. Nitrogenous and phosphatic fertilizers falling under:

   A inorganic fertilizers under "18-Fertilizers" in the First Schedule to IDR Act, 1951.

Chemicals (other fertilizer).

1. heavy inorganic chemicals including petrochemicals,
2. heavy inorganic chemicals,
3. organic fine chemicals,
4. synthetic resins and plastics,
5. man-made fibres,
6. synthetic rubber,
7. industrial explosives,
8. technical grade insecticides, fungicides, weedicides, and the like,
9. synthetic detergents,
10. miscellaneous chemicals (for industrial use only) (a) catalysts and catalyst supports, (b) photographic chemicals, (c) rubber chemicals, (d) polyols, (e) isocyanides, urethanes, etc. (f) speciality chemicals for enhanced oil recovery, (g) heating fluids, (h) coal tar distillation and products therefrom, (i) tonnage plants for the manufacture of industrial gases, (j) high altitude breathing oxygen/medical oxygen, (k) nitrous oxide, (l) refrigerant gases like liquid nitrogen, carbondioxide etc. in large volumes, (m) argon and other rare gases, (n) alkali/acid resisting cement compound, (o) leather chemicals and auxilliaries.

Drugs and Pharmaceuticals According to drug Policy.

Paper and pulp including paper products. Industrial laminates.

Automobile tyres and tubes,

Rubberised heavy duty industrial beltings of oil types.

Rubberised conveyor beltings.

Rubber reinforced and lined fire fighting hose pipes.

High pressure braided hoses.

Engineering and industrial plastic products.

Plate glass.

1. glass shells for TV tubes,
2. float glass and plate glass,
3. H. T. insulators,
4. glass fibres of oil types, Ceramics,

1. ceramics for industrial uses.

Cement Products

1. Portland cement,
2. gypsum boards, wail boards and the like.

High technology reproduction and multiplication equipment,

Carbon and carbon products:

1. graphite electrodes and anodes,
2. impervious graphite blocks and sheets.

Pretensioned high pressure R C C pipes.

Rubber machinery.

Printing Machinery

1. web-fed high speed off-set rotary printing machine having output of 30,000 or more impressions per hour,
2. Photo composing/type setting machines,
3. multi-colour sheet-fed off-set printing machines of size of 18" x 25" and above,
4. high speed rotogravure printing machines having output of 30,000 or more impressions per hr.

Welding electrodes other than those for welding mild steel.

Industrial synthetic diamonds, Photosynthesis improvers.

Genetically modified free living symboitics nitrogen fixer.

Pheromones.

Bio insecticides.

Extraction and upgrading of minor oils,

Pre-fabricated building material.

Soya Products

1. soya texture proteins,
2. soya protein isolates,
3. soya protein concentrates,
4. other specialist product of soyabean,
5. winterised and de-odourised refined soyabean oil.

Certified high-yielding hybrid seeds and synthetic seed.

Certified high-yielding plants developed through plant issue culture.

All food processing industries other than milk food, malted food, and flour, but excluding the items reserved for small-scale sector.

All items of packaging for food processing industries excluding the items reserved for small-scale sector.

Hotels and tourism-related industry.

38

Joint Ventures

A joint venture is an enterprise which is jointly owned and managed by a local entrepreneur and a foreign entrepreneur. In some cases, there are more than two parties involved. For example, Pepsi's Indian joint venture involves Voltas and Punjab Agro Industries Corporation.

A joint venture may be brought about by:

(i) both the foreign and local entrepreneurs jointly setting up a new firm;

(ii) foreign firm buying an interest in a local firm; or

(iii) a local firm acquiring shares in an existing foreign firm.

It is also a common practice to split the local share holding between a partner and various public participation (including public sector firms or industrial development organisations).

In this section we discuss the Indian joint ventures abroad. By the term joint venture what is generally referred to is the Indian joint ventures abroad.

Why Joint Ventures?

The important reasons or advantages of joint ventures are the following:

(i) In countries where fully foreign owned firms are not allowed or favoured, joint venture is the alternative if the international marketer is interested in establishing an enterprise in the foreign market. Many foreign companies entered the communist, socialist and other developing countries by joint venturing.

(ii) One important advantage of joint venturing is that it permits a firm with limited resources to enter more foreign markets than might be possible under a policy of forming wholly owned subsidiaries.

(iii) In some cases, it is also possible to swap know-how (such as patent rights for equity) in forming joint venture as a means of securing ownership in foreign operations.

(iv) Partnership with local firms has certain specific advantages. The local partner would be in a better position to deal with the government and the publics. Further, there would not be much public hostility when there is a local partner; it would be much less when there is equity holding by the government sector and the public.

A right local partner for a joint venture can have major impact on a firm's competitiveness because such a partner can serve as a cultural bridge between the company and the market.

Indian JVs Abroad

Indian was not able to make much progress in investing abroad due to various reasons like government control, lack of competition in the domestic market etc.

At the beginning of 1995, there were 177 jointventures with a total equity of Rs. 179 crores in operation and 347 with total investment of Rs. 1,400 crores under implementation.

The largest number of the Indian JVs are in Asia, mostly in South-East Asia. Europe and America have a good number. There is also a significant number in Africa.

The Indian JVs are mostly in engineering industries; construction; consultancy; shipping; trading; textiles; electrical and chemicals.

The total benefit accrued to the country from the joint ventures till the end of 1991 was only Rs. 451.73 crores. This included dividend of Rs. 41.45 crores; other repatriations of Rs. 72.3 crores and Rs. 337.98 crores from additional investments.

The new economic policy of India is expected to encourage foreign investments by Indian companies. The curbs on growth, even by mergers and acquisitions, have been removed, financing restrictions have been eased, areas of business opened to the private sector companies have been substantially enlarged and foreign tie up policies have been liberalised. Further, domestic market is becoming increasingly competitive. All these factors should encourage the Indian companies to invest in other countries and take advantage of the economic liberalisation in many foreign countries.

Indications are that several Indian companies are drawing up plans for establishing subsidiaries or joint ventures abroad. The 1990s is a decade of real test for Indian companies in this respect.

Guidelines for Indian Investment Abroad

Reserve Bank of India (RBI) has issued guidelines for Indian direct investment in joint ventures and wholly owned subsidiaries abroad. These guidelines which came into effect since December 1, 1995, are applicable to investments in newly promoted foreign concerns and all initial or additional investments in existing foreign concerns and investments made to acquire foreign business. These guidelines cover concerns engaged in any industrial activity, trading or services such as hotels, tourism and financial services. Portfolio investments in foreign concerns and investment in foreign concerns engaged in banking business are not covered by these guidelines. Such cases will be considered on merit by the appropriate authority.

With effect from December 1, 1995, the processing agency for foreign investment by Indian parties was transferred from the ministry of commerce to the RBI.

The guidelines issue by government on 21st October 1992 had divided the proposals for foreign investment into two categories, viz., automatic approval cases and other cases.

An application for direct investment in a foreign concern was eligible for automatic clearance within 30 days of receipt of the application if either of the two parameters was satisfied.

(1) The total value of the direct investment by the Indian party did not exceed US $ 2 million of which the subscription in cash by the Indian party did not exceed US $ 5 lakhs. The reminder of the direct investment could be contributed by the capitalisation in full or in part by:

(a) Indian-made plant, machinery, equipment and components supplied to the foreign concern;

(b) The proceeds of goods exported by the Indian party to the foreign concern;

(c) Fees, royalties, commissions or other entitlements from the foreign concern for the supply of technical know-how, consultancy, managerial or other services.

All other cases of direct investment was considered on merit by an inter-ministerial committee in the ministry of commerce and a decision was to be given within 90 days of the receipt of the application.

According to the new guidelines which became effective since December 1, 1995, Indian direct investments abroad below $ 4 million will be cleared by the RBI under the *fast track* route within 21 days. Investments above this amount will be processed by a special committee constituted by the RBI containing representatives of the ministries of finance, commerce and external affairs.

The *fast track* approval will be available only if the investment amount does not exceed 25 per cent of the annual average export earnings of the Indian promoter company during the preceding three years. Further, the invested amount will have to be fully repatriated by way of dividend and royalty within a period of five years from the time of investment. Indian investor must compulsorily repatriate to India their foreign exchange earnings within the stipulated time through normal banking channels.

39

Multinational Corporations

Large corporations having investment and business in a number of countries, known by various names such as multinational corporation, known by various names such as multinational corporation, transnational corporation, international corporation and global corporation (or firm, company or enterprise) have become very powerful driving force in the world economy. Although the multinational corporation took birth in the early 1860s, it was after the Second World War that the multinationals have grown rapidly.

In 1862-63, the U.S. based Singer Sewing Machines established production facility in England. A year or two before Singer did this, an English company set up local production facilities in Australia. The first MNC came to India in 1921.

In the early days, the United States was the home of most of the MNCs. Now there are a number of European and Japanese multinationals. Multinationals have been emerging from the developing countries too.

Definitions

There is, however, no universally accepted definition of the term multinational corporation. As an ILO report observes, "the essential nature of the multinational enterprises lies in the fact that its managerial headquarters are located in one country (referred to for convenience as the "home country") while the enterprise carries out operations in a number of other countries as well ("host countries").[1] Obviously, what is meant is "a corporation that controls production facilities in more than one country, such facilities having been acquired through the process of foreign direct investment. Firms that participate in international business, however large they may be, solely by exporting or by licensing technology are not multinational enterprises."[2]

---

[1] ILO, *Multinational Enterprises and Social Policy* (Geneva: ILO, 1973) p. 3.

Jacques Maisonrouge, president of IBM World Trade Corporation, defines an MNC as a company that meets five criteria:[3]

(i) It operates in many countries at different levels of economic development.

(ii) Its local subsidiaries are managed by nationals.

(iii) It maintains complete industrial organisations, including R and D and manufacturing facilities in several countries.

(iv) It has a multinational central management.

(v) It has multinational stock ownership.

Jame C. Baker defines the multinational corporation as a company:[4]

(a) which has a direct investment base in several countries; and

(b) which generally derives from 20 per cent to 50 per cent or more of its net profits from foreign operations; and

(c) whose management makes policy decisions based on the alternatives available anywhere in the world.

Terms such as international corporation, multinational corporation, transnational corporation and global multinationals have evolved into certain advanced stage of transnational organisation and operations that it becomes necessary to draw some distinction between these terms.

A company with manufacturing investment (or service operation) in at least one foreign country may be regarded as an *international corporation*. However, multinational implies international operations of more significance than this, as indicated in the definition of the MNC given above, such as direct investment in several countries and a considerable share of the total business being in foreign countries. A multinational corporation is, obviously, an international corporation. Only those international corporations which satisfy certain criteria as described above, may be regarded as multinationals.

It would be useful to draw a distinction between the multinational corporation and transnational corporation.

---

[2] Leonard Gomes, *International Economic Problems* (London: Macmillan Press Ltd., 1978), p. 119.

[3] Cited in V.H. Kirpalani, *International Marketing* (New Delhi: Prentice Hall of India, 1987), p. 58.

[4] Cited by L.S. Walsh, *International Marketing* (Bristol: Macdonald and Evans, 1978), pp. 5-6.

"Multinational companies are usually organised around a national headquarters, from which international control is exercised — they still have a national identity, even though their subsidiaries may not always care to allow that identity to obtrude in the markets they serve."[5] A *transactional company* is a multinational in which both ownership and control are so dispersed internationally. There is no principal domicile and no one central source of power.[6] Examples include Royal Duch-Shell and Unilever.

The term *global corporation* is also often used to mean more or less the same thing as the transnational corporation.

It may also be pointed out here that some marketing and management experts add some essential dimension to the term global corporation, although it is not agreed upon by many others. According to them, a global corporation is one which views the entire world as a single, homogeneous, market which should be catered to by globally standardised products. Theodore Levitt, the world renowned professor of marketing who has championed this line of thinking, observes that while "the multinational corporation operates in a number of countries and adjusts its products and practices in each — at a high relative cost", "the global corporation operates with resolute constancy — a low relative cost — as if the entire world (or major region of it) were a single entity; it sells the same thing the same way every where."[7] According to Levitt, "the world is becoming a common market place in which people — no matter where they live — desire the same products and life styles. Global companies must forget the idiosyncratic differences between countries and cultures and instead concentrate on satisfying universal drives."[8] Levitt who says that "the world's needs and desires have been irrevocably homogenized" argues that this "makes the multinational corporation obsolete and the global corporation obsolete."[9] Levitt's theory has been strongly criticised by several experts.*

Dominance of MNCs

The economic dominance of the multinationals is manifested by the fact that the MNCs control between a quarter and a third of all world production and the total sales of their foreign affiliates is about the same as the gross national product of all developing countries excluding oil-exporting developing countries.[10]

---

[5] *Ibid.*, p. 6.

[6] *Ibid.*, p. 6.

[7] Theodore Levitt, "The Globalisation of Markets," *Harvard Business Review*, May-June 1983, 92-3.

[8] Cited by Michell Lynch, "Harvard's Levitt called Global Marketing Guru," *Advertising Age*, June 25, 1984, p. 49.

[9] Theodore Levitt, *op.cit.*, p. 93.

* For details see Francis Cherunilam, *International Trade and Export Management*, 3rd edition (Himalaya Publishing House).

The economic clout of the MNCs is indicated by the fact that the GDP of most of the countries is smaller than the value of the annual sales turnover of the multinational giants. In 1991, the value of the sales of the Japanese multinational, C. Itoh, the biggest multinational in terms of sales turnover, was $ 151.6 billion. Of the total 101 developing countries with a population of more than one million each, listed by the world development report only five countries (India, China, Mexico, Brazil and Republic of Korea) had a GDP which was more than this figure. There were also several developed countries whose value of GDP was less than this. It may be noted that in 1990, India's GDP was only $ 254.5 billion.

Because of the differences in the definition adopted, the estimates of the number of MNCs also vary. According to the United Nations' *World Investment Report 1994* , there are now more than 37,000 TNCs, which have more than 2 lakh affiliates

The United States and Europe are the homes for most of the MNCs. Their shares have, however, been declining because of the growth of MNCs in other regions. Japanese MNCs have made rapid strides in the 1970s and 1980s. In 1991, majority of the 10 largest multinationals (in terms of sales) were Japanese. Multinationals from developing countries such as S. Korea and Taiwan have also been making their presence increasingly felt.

Investment Pattern

The major part of the business of the MNCs is in the developed economies. The share of the developed countries in the total overseas investment was, in fact, increasing. According to Professors Dunning and Stopford, developing countries' share of foreign direct investment slipped to 27 per cent by 1980 from 31 per cent in 1971.[11] It dropped further to 17 per cent during 1986-90.[12] However, in 1991, although the MNCs' investments in the developing countries, were still much higher than in the developing countries, there was an increase of 38 per cent in the MNCs' investment in the LDCs while there was a decline of 23 per cent in the developed countries. The economic reforms ushered in the developing countries, particularly the liberalisation of foreign investment and privatization might have given a boost to the FDI in these countries.

In the case of the LDCs, the investment and employment created by the MNCs have been chiefly concentrated in about a dozen of the nations; Brazil, Mexico, Hong Kong, the Philippines, Singapore and South Korea accounting for a major share.

---

[10] Estimates of the *Brandt Commission*.

[11] "Multinationals: Coming from the Cold," *Business Standard*, 6 March, 1983.

[12] *IMF Survey*, July 20, 1992, p. 228.

As the Brandt Commission observes, foreign investment has moved to limited number of developing countries, mainly those which could offer political stability and a convenient economic environment, including tax incentives, large markets, cheap labour and easy access to oil or other natural resources. In poor countries foreign investment is mainly in plantations and minerals, or in countries with large internal markets like India. The Brandt Commission has also observed that private investment can supplement and complement aid, but it cannot substitute for it: it tends not to move to the countries or sectors which most need aid.

Investment Motives

There are a variety of motives for international investments.

They include the following:

1. To circumvent the tariff walls. For example, getting behind the E.E.C.'s common external tariff was certainly a major consideration for U.S. companies during the last many years.[13] Recently there has been a spurt in such investments in the EEC by companies from Japan and some other countries.
2. To reduce the production costs by making use of the cheap labour and factors in the home countries and by avoiding/reducing transport costs.
3. To gain dominance in the foreign market and to effectively fight competition.
4. To adjust to the government regulation in the host country. For example, some countries prefer foreign investment and domestic production out of it to import of goods.
5. To mitigate the impact of home country regulations, like anti-trust regulations, regulations against industries causing ecological problem, etc.
6. To exploit the natural resources of the host countries.
7. To enjoy the benefits of tax-havens.

MNCs and International Trade

Peter Drucker, the well-known writer on Management, remarks that multinationalism and expanding world trade are two sides of the same coin.[14] He points out that the period of most rapid growth of multinationals — the fifties and sixties — was the period of most rapid growth of multinational trade. Indeed, during this period the world trading economy grew faster —

---

[13] Cited in Leonard Gomes, *op. cit.*, p. 124.

[14] Peter Drucker, *Management* (Bombay: Allied Publishers Pvt. Ltd., 1975) p. 733.

at an annual rate of 15 per cent or so in most years — than even the fastest growing domestic economy, that of Japan.[15]

There seems to be a misconception that the growth of the MNCs has to do with trade restrictions. Peter Drucker points out that far from being a cause of multinationalism, protectionism is incompatible with it; indeed an emergence of protectionism would be the greatest threat to the MNCs. The best proof that protectionism is not at the bottom of the multinational trend is the European development. The rise of the multinationals began when continental Europe abolished protection and joined in a common market. Further, it is not in the most heavily protected industries where multinationalism has forged ahead the fastest. It came late, for instance, in the chemical industry which is very heavily protected. But pharmaceuticals where protection plays minor role, was a leader from the start. And there has been almost no multinationalism in heavily protected steel industry.[16]

It is estimated that between one-fourth and one-third of manufactured goods now moving in world trade are being shipped from one branch to another of the MNCs; that is, they are intra-company shipments. The sale of foreign subsidiaries in the host countries in which they are located are three to four times as large as total world exports.[17] Apart from trade in commodities, other transactions also take place extensively between the different parts of these enterprises, for example the granting of loans, the licensing of technology and the provision of services. In all such transactions, transfer prices may be settled which are different from the price which would have been the case between independent parties operating at arms length. Such differences may reflect the legitimate business concerns of the companies but are also capable of being used in order to shift profits from high to low tax countries or to get around exchange or price controls or customs duties. As the Brandt Commission observes, the ability of multinational to manipulate financial flows by the use of artificial transfer prices is bound to be a matter of concern to governments. The monitoring and control of transfer prices involves inter governmental cooperation and measures to secure due disclosure of relevant information by companies. This is necessary to make effective tax laws covering transfer prices which exist in many countries. Intra-firm trade also opens up the possibility for corporations to impose restrictive business practices within their own organisation; they can limit the exports of their affiliates, allocate their markets between nations or restrict the use of their technology or that developed by their affiliates. Such practices, although best pursued in the best business interests of the companies, may conflict with the developmental objectives and national interests of host countries. [18]

---

[15] *Ibid.*, p. 733.

[16] *Ibid.*, p. 733.

[17] James C. Ingram, *International Economic Problems* (New York: John Wiley and Sons, 1928), p. 164.

Benefits of MNCs

As the Preface to the ILO report on Multinational Enterprises and Social Policy observes, "for some, the multinational companies are an invaluable dynamic force and instrument for wider distribution of capital, technology and employment; for other, they are monsters which our present institutions, national or international cannot adequately control, a law to themselves with no reasonable concept, the public interest or social policy can accept." [19]

We will mention the important arguments in favour of an against the MNCs. MNCs, it is claimed, help the host countries in the following ways:

(1) MNCs help increase the investment level and thereby the income and employment in the host country.

(2) The transnational corporations have become vehicles for transfer technology, especially to the developing countries.

(3) They also kindle a managerial revolution in the host countries through professional management and the employment of highly sophisticated management techniques.

(4) The MNCs enable the host countries to increase their exports and decrease their import requirements.

(5) They work to equalise the cost of factors of production around the world.

(6) MNCs provide an efficient means of integrating national economies.

(7) The enormous resources of the multinational enterprises enable them to have very efficient research and development systems. Thus, they make a commendable countribution to inventions and innovations.

(8) MNCs also stimulate domestic enterprise because to support their own operations, the MNCs may encourage and assist domestic suppliers.

(9) MNCs help increase competition and break domestic monopolies.

Demerits

MNCs have, however, been subject to a number of criticisms, like those mentioned below:

---

[18] *North-South: A Programme for Survival (Report of the Independent Commission on International Development Issues)* (London: Pan Books, 1980) pp. 188-89.

[19] ILO, *op.cit.*

1. As Leonard Gomes points out, the MNC's technology is designed for world-wide profit maximization, not the development needs of poor countries, in particular employment needs and relative factor scarcities in these countries. In general, it is asserted, the imported technologies are not adapted to (a) the consumption needs, (b) the size of domestic markets, (c) resource availabilities, and (d) stage of development of many of the LDCs.[20]
2. Through their power and flexibility, MNCs can evade or undermine national economic autonomy and control, and their activities may be inimical to the national interests of particular countries.
3. MNCs can have unfavourable effect on the Balance of payments of a country. For instance, the Coca-Cola, until 1978, had remitted abroad nearly Rs. 6 crores on an initial investment of Rs. 6.6 lakhs in India.
4. MNCs may destroy competition and acquire monopoly powers.
5. The tremendous power of the global corporations poses the risk that they may threaten the sovereignty of the nations in which they do business.
6. MNCs retard growth of employment in the home country.
7. The transnational corporations cause fast depletion of some of the non-renewable natural resources in the host country.
8. The transfer pricing enables MNCs to avoid taxes by manipulating prices on intra-company transactions.

Recent Trends

There has been a considerable change in the attitude toward the multinationals. They are not subject to as severe criticisms as in the past. Even communist countries have wide opened their doors for the MNCs.

Streeten points out that the following trends suggest that the role of the MNCs has to be reassessed. [21]

(i) Many more nations are now competing with U.S. multinationals in setting up foreign activities, which means that the controversy is no longer dominated by nationalistic considerations. Japanese and European firms figure prominently among the new multinationals.

(ii) Developing countries themselves are now establishing multinationals. In addition to companies from the Organisation of Petroleum Exporting Countries (OPEC), and firms established in tax-haven countries, the leading countries where multinationals are being established are Argentina, Brazil, Colombia, Hong Kong,

---

[20] Leonard Gomes, *op. cit.*, p. 131.

[21] Paul Streeten, "Multinationals Revisited," *Finance and Development*, June 1979, pp. 39-42.

India, the Republic of Korea, Peru, the Philippines, Singapore, and Taiwan.

(iii) Not only do host countries deal with a greater variety of foreign companies, comparing their political and economic attractions, weighing them against their costs, and playing them off against one another, but also the large multinationals are being replaced by smaller and more flexible firms. An increasingly alternative organizations to the traditional form of multinational enterprise are becoming available: banks, retailers, consulting firms, and trading companies are acting as instruments of technology transfer.

(iv) Some multinationals from developed countries have accommodated themselves more to the needs of the developing countries.

Perspective

Future holds out an enormous scope for the growth of MNCs. The changes into economic environment in a large number of countries indicate this. For instance, the number of bilateral treaties that promote and/or protect FDI has increased markedly, with some 64 such treaties signed in the first 18 months of the 1990s compared with 199 such treaties during 1980-89. Further, of the 82 changes made in FDI policy by 35 countries during 1991, 80 were in the direction of increased liberalisation. Privatisation programmes in more than 70 countries offer new opportunities for foreign investors, especially in the service sector.[22]

The *World Investment Report 1992* describes several developments that point to a rapidly changing context for economic growth, along with a growing role for transnational corporation in that process. These include: [23]

(i) increasing emphasis on market forces and a growing role for the private sector in nearly all developing countries;

(ii) rapidly changing technologies that are transforming the nature of organisation and location of international production;

(iii) the globalisation of firms and industries;

(iv) the rise of services to constitute the largest single sector in the world economy; and

(v) regional economic integration, which has involved both the world's largest economies as well as selected developing countries.

---

[22] *IMF Survey*, July 20, 1992, *op. cit.*, pp. 227-8.

[23] *Ibid.*, p. 228.

Code of Conduct

As the Brandt commission observes, there is now much interest in trying to formulate international codes of conduct for the transfer of technology, for restrictive business practices and transnational corporations. Definite progress has been made in some of these negotiations. Any code, of course, will only work if it can influence the actual behaviour of home and host governments and of investors. The major elements of any effective code should be capable of being eventually translated into agreements between governments. Such an overall regime will have to have elements of both persuasion and effective implementation, with flexible approaches and attitudes on all sides. The participating governments will have to consult with labour and business to find the means to reconcile interests and to monitor and implement the arguments. The ILO has created a committee for consultation and monitoring the Code of Conduct relating to multinational enterprises. This offers one model.

According to the Brandt Commission, the principal elements of an international regime for investment should include:

1. A framework to allow developing countries as well as transnational corporations to benefit from direct investment on terms contractually agreed upon. Home countries should not restrict investment or the transfer of technology abroad, and should desist from other allocation arrangements. Host countries in turn should not restrict current transfers such as profits, royalties and dividends, or the repatriation of capital, so long as they are on terms which were agreed when the investment was originally approved or subsequently negotiated.
2. Legislation promoted and coordinated in home and host countries, to regulate the activities of transnational corporations in such matters as ethical behaviour, disclosure of information, restrictive business practices, anti-competitive practices and labour standards. International codes and guidelines are a useful step in that direction.
3. Cooperation by governments in their tax policies to monitor transfer pricing and to eliminate the resort to tax havens.
4. Fiscal and other incentives and policies towards foreign investment to be harmonized among host developing countries, particularly at regional and sub-regional levels, to avoid the undermining of the tax base and competitive positions of host countries.
5. An international procedure for discussions and consultations on measures affecting direct investment and the activities of transnational corporations.

FOREIGN INVESTMENT BY INDIAN COMPANIES

Although some developing countries like S. Korea and Taiwan, whose economic position had not been better than that of India when India started planned development, have made substantial DFI in other countries, Indian companies have not made any significant foreign investment so far. Although government of India's policy has been one of encouraging foreign investment by Indian companies subject to certain conditions, several factors like the domestic economic policy and the domestic economic situation have been deterrents to foreign investment by Indian companies.

By restricting the areas of operation and growth, the government policy seriously constrained the potential of Indian companies to make a foray into the foreign countries through investment. Added to this was the attraction of the protected domestic market which was, in many cases, a sellers' market which made the Indian companies to ignore the foreign markets.

By the end of 1991, a total of 66 wholly owned subsidiaries were established by Indian companies in 18 countries. The total equity of these 66 subsidiaries were a meagre Rs. 73.84 crores.[24]

Out of these 66 foreign subsidiaries, only 44 were operational by the end of 1991; the remaining ones were under implementation. Out of these 44 subsidiaries, 13 were in U.K.; 11 in USA; 4 in Singapore; 3 each in Germany and Switzerland and 2 in Hong Kong.

Most of the subsidiaries are in trading, marketing, consultancy, hotel, computer software and shipping service; only a few are in the manufacturing field.

At the end of 1991, there were also 245 Indian joint ventures abroad, dispersed over 43 countries. Details were given in an earlier chapter.

The new economic policy of India is expected to encourage foreign investments by Indian companies. The curbs on growth, even by mergers and acquisitions, have been removed, financing restrictions have been eased, areas of business opened to the private sector companies have been substantially enlarged and foreign tie up policies have been liberalised. Further, domestic market is becoming increasingly competitive. All these factors should encourage the Indian companies to invest in other countries and take advantage of the economic liberalisation in many foreign countries.

Indications are that several Indian companies are drawing up plans for establishing subsidiaries or joint ventures abroad. The 1990s is a decade of real test for Indian companies in this respect.

---

[24] The Statistics quoted in this section are from Girish Chandra, "Measures to promote joint ventures abroad," *Financial Express*, July 6, 1992.

MULTINATIONALS IN INDIA

Comparatively very little foreign investment has taken place in India due to several reasons, as stated in the previous chapter (like the dominant role assigned to the public sector in the industrial policy and the restrictive government policy towards foreign investment). Some multinationals, Coca Cola and IBM, even left India in the late 1970s as the government conditions were unacceptable to them.

A common criticism against the MNCs is that they tend to invest in the low priority and high profit sectors in the developing countries, ignoring the national priorities. However, in Indian the government policy confined the foreign investment to the priority areas like high technology and heavy investment sectors of national importance and export sectors. Firms which had been established in nonpriority areas prior to the implementation of this policy have, however, been allowed to continue in those sectors.

The controversial Foreign Exchange Regulation Act (FERA), 1973, required the foreign companies in Indian to dilute the foreign equity holding to 40 per cent (exceptions were allowed in certain cases like high technology and export oriented sectors).

An often heard criticism is that multinationals drain the foreign exchange resources of the developing countries. However, Aiyar's study indicates that, contrary to the popular belief, foreign companies are less of a drain on foreign exchange reserves than Indian ones. He also points out that the public sector has a higher propensity to use foreign exchange on a net basis than multinationals. In fact, the foreign exchange outgo the public sector alone is greater than the entire trade deficit of the country.[25]

It is not a right approach to estimate the net impact of multinationals on the foreign exchange reserves by taking the net foreign exchange outflow or inflow. If a multinational is operating in an import substitution industry, the net effect on the foreign exchange reserves could be favourable ·even if there is a net foreign exchange outflow by the company.

Multinationals in several developing countries make substantial contribution to export earnings. The performance in the case of India has, however, been very dismal. This is attributed mostly to the government policy. "We have consistently followed policies in India that discriminate against export production and in favour of production for the local market. In this milieu it has not made sense for the Indian private sector or public sector to focus on exports. Naturally, it has not made sense of foreign companies either. In 1947, foreign companies did not have an anti-export of tea and jute manufactures. Only after Jawaharlal Nehru decided to emphasise

---

25. Swaminathan S. Anklesaria Aiyar, "Multinationals: Do they export too little", *The Economic Times*, July 1, 1992, p. 10.

import-substitution at the expense of exports did foreign (and Indian) companies spurn exports."[26]

Although export promotion has been pursued since the Third Plan, the highly protected domestic market and the unrealistic exchange rate made the domestic market much more attractive than exports. However, since the mid 1980s with the economic liberalisation that increased domestic competition and the steady depreciation of the rupee, exports began to become attractive and several foreign companies and companies with foreign participation, as well as Indian companies, have become serious about exports. This was reflected in the acceleration of the export growth.

The new policy is expected to give a considerable impetus for MNC's investment in India. However, foreign companies find the policy and procedural environment in India still so perplexing and disgusting that a multinational, Motorola, even shifted some of the projects, originally earmarked for India, to China where the government environment is much more conducive.

At the end of March 1990, there were 469 foreign companies in India. (A foreign company is defined as a company incorporated outside India, but has a place of business in India). In addition, there are many Indian companies with foreign equity participation.

Several Indian outfits of MNCs like Pond's, Johnson and Johnson, Lipton, Brook Bond, Colgate-Palmolive etc. are in the low technology consumer goods sector. Hindustan Lever, while popular in the low-tech consumer goods, has diversified into high technology and export oriented sectors. Pond's has diversified into thermometers, leather uppers and mushrooms entirely for exports (Pond's, Brook Bond, Lipton and Hindustan Lever come under the multinational umbrella of Unilever) ITC (Indian Tobacco Company — formerly Imperial Tobacco Company) has diversified into areas like hotel, paperboards and edible oil. There are MNCs, like Siemens, which are in high technology areas. There are several MNCs in the pharmaceutical industry, like Glaxo, Bayer, Sandoz, and Hoechst. MNCs like Marubeni and Nissho Iwai confine to foreign trade.

As argued in the previous chapter, it is wrong to assume that the success of MNCs or foreign brands is guranteed in developing countries and that the domestic firms, particularly the small ones, will not be able to withstand the competition from them. There are several Indian cases to prove this.

The Double Cola has not been a success in India. Parle appeared to be very much worried about the entry of the Pepsi and it did every thing to prevent its entry. But, when the competition became a reality, it faced it head on and the reports are that the Parle brands are far outselling the Pepsi's. In the soft-drink concentrate market, while Juc of the Kothari-General Foods (MNC) combine failed, the product of the small firm, Pioma industries (Rasna) has become a grand success. Asian Paints which had its beginning as a small unit has become the unrivaled industry leader, successfully fighting multinationals. Similarly, the Nirma story is well known. There are several foreign brands like, Tang, which have miserably failed.

---

[26] *Ibid.*

In short, the feeling that multinationals and foreign brands will have a runaway success and domestic firms will not be able to survive their competition is not right.

40

Regulation and Promotion of Foreign Trade

The Export-Import Policy (Exim Policy) reflects the foreign trade policy of India. The policy is implemented mostly by means of the regulatory framework provided by the Foreign Trade (Development and Regulation) Act, 1992.

Control of foreign trade in India dates back to the early years of the Second World War. Import Control was introduced in 1940 as a war time measure under the Defence of India Rules with the primary objective of conserving the foreign exchange resources and restricting physical imports so as to reduce the pressure on the limited available shipping space. Initially, the import of only 68 commodities, mainly consumer goods, were brought under control. Subsequently, with the increasing pressure on the foreign exchange resources, import control was extended to other commodities as well.

After the end of the war, the Defence of India Rules lapsed and hence in September 1946, the Emergency Provisions (Continuance) Ordinance, 1946, was promulgated to continue the import trade control. This was ultimately replaced by the Imports and Exports (Control) Act, 1947, which came into force with effect from 25th March 1947. This Act gave the Government enormous powers of control over the foreign trade of India. The imports and exports was controlled by the Government under the Imports (Control) Order and Exports (Control) Order issued under this Act. The Imports and Exports (Council) 1947 was replaced by the Foreign Trade (Development and Regulation Act), 1992 (FTDRA).

Besides the FTDR Act there are some laws which control the trade in certain items. For instance, the export of antiquities is regulated under the

Antiquities and Art Treasures Act 1972; export of coffee is regulated by the Coffee Board under the Indian Coffee Act 1942; export of tea is regulated under the Tea Act, 1953, etc. The export and import currency notes, bank notes and coins have been controlled by the Reserve Bank of India under the Foreign Exchange (Regulation) Act, 1973 (FERA).

The major concern of Government in the past was restriction of imports with a view to controlling the trade deficit and protection of domestic industries against foreign competition. Imports were, therefore, very much restricted by prohibition of imports of many items, import licensing, very high import duties and foreign exchange restrictions. The foreign trade policy was characterised by the overtone of negativism.

In tune with the general economic liberalisation ushered in India in 1991, the Exim policy and the regulatory mood and mode have undergone a change. The difference between the past and present attitudes is reflected in the change in the title of the law — from Imports and Exports (Control) Act to Foreign Trade (Development and Regulation) Act and the differences in the statement of the objectives of the old Act was to prohibit and control imports and exports; the objective of the present Act is to provide for the development and regulation of foreign trade by facilitating imports and augmenting exports.

The Foreign Trade Development and Regulation Act, 1992

This Act which replaced the (Imports and Exports Control) Act, 1947, came into force on 19th June 1992.

No export or import shall be made by any person except in accordance with the provisions of this Act, the orders and rules made under this Act and the export and import policy.

Objective

The objective of the Act is *to provide for the development and regulation of foreign trade by facilitating imports into, and augmenting exports from India and for matters connected therewith or incidental thereto.*

Main Provisions

The main provisions of the FTDR Act are the following:

(I) Development and Regulation: The FTDRA empowers the Central Government to make provision for the development and regulation of foreign trade by facilitating imports and increasing exports:

(II) Prohibition and Restriction: The Act also empowers the Central Government to make provision for prohibiting, restricting or otherwise regulating the import or export of goods as and when required. All goods which are so regulated under this sub-section shall be deemed to be goods the import or export of which has been prohibited under section 11 of the Customs Act, 1962, and all the provisions of that Act shall have effect accordingly.

It may noted that it is according to this sub-clause that the Government has provided for negative lists of exports and imports in the Exim policy.

(III) Exim Policy: The Act lays down that the Central Government may, from time to time, formulate and announce the export and import policy and may also amend that policy.

(IV) Director General of Foreign Trade: The Act provides for the appointment by the Central Government, of a Director General of Foreign Trade for the purpose of this Act. The DGFT shall advise the Central Government in the formulation of the export and import policy and shall be responsible for carrying out that policy. [The corresponding authority under the Imports and Exports (Control Act), 1947, was called the Chief Controller of Imports and Exports (CCIE)]

(V) Importer Exporter Code Number: The Act lays down that no person shall make any import or export except under an Importer-Exporter Code (IEC) Numbers granted by the DGFT or the Officer authorised by him in this behalf.

The Director General is empowered to suspend or cancel the Importer Exporter Code Number granted to any person if there is valid reason to do so, like contravention of law relating to Central excise or customs or foreign exchange or having conducted import/export in a manner gravely prejudicial to the trade relations of India with any foreign country or in a way detrimental to the interests of the country.

(VI) Issue and Suspension/Cancellation of Licence: The Director General or any other Officer authorised under this Act is empowered to suspend or cancel a licence issued for export or import of goods in accordance with this Act for good and sufficient reasons, after giving the licence holder a reasonable opportunity of being heard.

(VII) Search Inspection and Seizure: Where any contravention of any condition of the licence or letter of authority under which any goods are imported is suspected or made, any person authorised by the Central Government may search, inspect and seize such goods, documents, things and conveyances subject to such requirements and conditions as may be prescribed.

(VIII) Penalty for Contravention: Where any person makes or abets or attempts to make any export or import in contravention of any provisions of this Act or any rules or orders made under this At or the Exim policy, he shall be liable to a penalty not exceeding one thousand rupees or five times the value of the goods involved, whichever is more.

EXPORT-IMPORT POLICY

Prior to 1985, Government of India used to announce the Exim Policy annually. However, with a view to imparting continuity and stability in the policy it was decided to give the Exim Policy validity for three year and the first three year policy was announced in 1985 (for the period 1985-88). It was later felt that the Exim Policy should coincide with the period of the Five Year Plan. The current Exim Policy 1992-97, thus, coincides with the period of the Eighth Five Year Plan.

Objectives

The principal objectives of this Policy are as follows:

(a) To accelerate the country's transition to an internationally oriented economy with a view to derive maximum benefit from the expanding global market opportunities;

(b) To augment the productivity, modernisation and competitiveness of Indian agriculture, industry and services and thereby to enhance their export potential and capabilities;

(c) To encourage the attainment of internationally accepted standards of quality and thereby improve the image of India's products abroad;

(d) To stimulate India's exports by facilitating access to required raw materials, intermediates, components, consumables and capital goods from the international market;

(e) The encourage efficient and internationally competitive import substitution within the liberalised framework of foreign trade;

(f) To impart greater transparency in the export-import policies and eliminate or minimise quantitative restrictions, licensing and other discretionary controls;

(g) To strengthen and stimulate the country's Research and Development (R & D) capabilities;

(h) To conserve the Forests and Wildlife of India and assist efforts towards the preservation, protection and promotion of a healthy eco-system for ensuring balanced and sustainable development; and

(i) To simplify and streamline the procedures governing exports and imports.

Directorate General of Foreign Trade and its network of Regional Offices are to strive to achieve the above objectives by acting as facilitators, coordinators and export promoters in close association with all the agencies concerned.

Salient Features

The salient features of the Exim Policy are the followings:

Liberalisation

A very important feature of the Exim Policy 1992-97 is freedom. It substantially eliminates licensing, quantitative restrictions and other regulatory and discretionary controls. All goods, except those coming under the *negative list* may be freely imported and exported. The negative list has been pruned from time to time.

The Negative List

The negative list consists of goods the import or export of which is:

(i) Prohibited;

(ii) Restricted by licensing or otherwise; or

(iii) Canalised

The prohibited goods shall not be exported or imported.

According to modification to the Exim Policy effective from April 1, 1995, there are three prohibited items of import, namely, animal tallow, fat and/or oils; animal rennet and wild animals including their parts and products and ivory. There are ten prohibited items of export, like all forms of wild animals including their parts and products with certain exceptions; exotic birds; animal tallow, fat and/or oils excluding fish oil; beef; human skeletons sandalwood excluding fully finished handicrafts and machine finished sandalwood products; certain wood and wood products; and certain chemicals.

Any goods, the export or import of which is restricted through licensing may be exported or imported only in accordance with a licence issued in this behalf. A licence may include such terms and conditions as may be specified by the licensing authority which may include the (i) quantity, description and value of the goods; (ii) Actual User Condition, if any; (iii) export obligation, if any; (iv) value addition to be achieved, if any; (v) the minimum export price, if any; and (vi) the country of origin and destination of the goods.

There is a large number of restricted items in the negative lists of imports and exports. Consumer goods; all kinds of timber logs; computer software; children's films; books; journals; news magazines and newspapers; and homoeopathic medicines and drugs are some examples of restricted items of imports. Examples of restricted items of exports include cattle; camel; chemical fertilizers; hides and skins; industrial leathers; and paddy.

The third category of goods in the restricted list are those goods the import or export of which is canalised. Canalisation means that the import or export of the goods concerned may be done only by the designated public sector agency (like the STC, MMTC or other organisations pertaining to particular products, such as Indian Oil Corporation for petroleum products, NDDB for certain dairy products and NAFED for certain agricultural products).

There are seven canalised items of imports (Examples: petroleum products; certain vegetable oils like coconut oil; certain seeds like copra and groundnut; and fertilizers). There are six canalised items of exports (Examples: petroleum products; certain mineral ores and concentrates; niger seeds; and onion).

Free Importability

The Exim Policy provides for liberal import of all goods except those in the negative list. Some of the important provisions are given below:

(i) Capital goods, raw materials, intermediates, components, consumables, spares, parts, accessories, instruments and other goods which are not regulated by the negative list or any other provision of the Exim Policy or any other law may be freely imported.

(ii) All second hand capital goods, having a minimum residual life of 5 years may be imported by Actual Users, without a licence, subject to actual user condition.

(iii) Capital goods, including aircraft, its components, spare parts and accessories, whether imported or indigenous, may be sent abroad for repairs, testing, quality improvement or upgradation of technology without a licence.

(iv) After completion of projects abroad, project contractors may import, without a licence, used construction equipment, machinery, related spares upto 15% of the CIF value of such machinery, tools and accessories. Used office equipment and vehicles may also be imported after completion of the projects abroad, without a licence provided they were used for at least one year.

(v) Bona fide household goods and personal effects may be imported as part of a passenger's baggage.

Import Facility for Exporters

As mentioned earlier, one of the important objectives is to stimulate India's exports by facilitating access to required raw materials, intermediates, components, consumables and capital goods from the international market. This is provided for under two schemes, viz., (a) duty exemption scheme; and (b) export promotion capital goods scheme.

Under the Duty Exemption Scheme, import of raw materials intermediates, components, consumables, parts, accessories, mandatory spares (not exceeding 5% of the CIF value of the licence), packing materials and computer software required for the product to be exported may be permitted to be imported duty free subject to specific export obligation under different categories of licences like *Advance Licence* (either value based or quantity based); *Advance Intermediate Licence* (for duty free import of inputs by the intermediate manufacturer for supply to the ultimate exporter or eligible deemed exporter; and *Special Imprest Licence* (for the duty free import of inputs to main/sub contractor for the manufacture and supply of goods eligible for deemed exports.

Under the Export Promotion Capital Goods Scheme (EPCGS) manufacturer exporters, merchant exporters and service providers are eligible for import of capital goods at concessional rate of import duty (15% of c. i. f. value) or zero duty in case c.i.f. value is Rs. 20 crores or more subject to specific export obligation.)

Deemed Exports

Deemed exports are eligible for duty exemption scheme, deemed exports drawback scheme, refund of terminal excise duty and special export licence as specified in the Exim Policy.

Deemed Exports mean those transactions in which the goods supplied do not leave the country and the payment for the goods in received by the supplier in Indian rupees. These transactions have the same effect as exports on the foreign exchange position of the country. For example supply of goods, by an Indian firm, against licences issued under the duty exemption scheme has the effect of saving foreign exchange (because if the licence holder imports the goods, instead of obtaining from India, it will cause outflow of foreign exchange). Other examples of deemed exports include supply of goods to units located in Export Processing Zones (EPZs), Software Technology Parks (STPs), Electronic Hardware Technology Parks (EHTPs) and Export Oriented Units (EOUs); and supply of capital goods to fertilizer plants if the supply is made under the procedure of international competitive bidding.

Export Houses and Trading Houses

From the beginning of the Second Five-Year Plan, the foreign exchange problem began to assume serious proportions, and the Government began to realise the need for vigorous export promotion. It was very clear that concentrated efforts should be made for the promotion of the export of non-traditional items. It was also realised that unless positive steps were taken to build up a number of merchant houses, concentrating almost exclusively on exports and capable of undertaking trade on a sustained basis, it would be impossible to compete successfully against the highly experienced and resourceful trading houses of other countries. The importance of promoting merchant houses was further underlined by the need for providing channels for the export of the products of the small scale sector.

In September 1960, certain broad principles for the recognition of export houses were formally adopted. The scheme of export houses has been modified a number of times thereafter.

An export house is defined as a registered exporter holding a valid Export House Certificate issued by the DGFT.

With a view to developing new products and new markets for exports, particularly from the small and cottage industries sector, a new scheme for the recognition of trading houses was introduced in 1981-82. Trading Houses are special category of Export Houses which have demonstrated export capabilities and have facilities for testing and quality control. Among the Trading Houses there are now two special categories known as Star Trading Houses and Super Star Trading House.

Merchant and manufacturer exporters and trading companies including those having foreign equity, Export Oriented Units (EOUs) and units located in

Export Processing Zones (EPZs)/Electronic Hardware Technology Parks (STPs) have been recognised as Export Houses, Trading Houses, Star Trading Houses or Super Star Trading Houses under criteria which were laid down from time to time. All such Export Houses, Trading Houses, Star Trading Houses and Super Star Trading Houses shall continue to enjoy the status accorded to them for the period for which such status was accorded.

However, when an Export House, Trading House, Star Trading House or Super Star Trading House applies afresh at the expiry of the aforesaid period for recognition as Export House, Trading House, Star Trading House or Super Star Trading House, as the case may be, it shall satisfy the criterion laid down hereinafter for grant of such recognition.

The criterion for recognition as Export House, Trading House, Star Trading House or Super Star Trading House shall be either on the basis of the FOB value or Net Foreign Exchange (NFE) earned on export of goods and services, including software exports, realised in freely convertible currency during the last three licensing years or the preceding licensing year, whichever is opted by the exporter, as given in the Table 1. Deemed exports, however, shall not qualify for the purposes of recognition.

Double weightage is given on NFE or FOB earned by the export of products manufactured by Small Scale Industries (SSI).

Double weightage is given on FOB earned by the export of sports goods.

Products manufactured by the handlooms and handicrafts sector, including hand-knotted carpets and silk products are given. (a) Double weightage on FOB earned by the export of such products; or (b) Triple weightage on NFE earned by the export of such products.

RELATED MEASURES

The new Exim policy is but a part of the new economic policy of India. Besides the Exim Policy, there are several other measures having a bearing on the trade flow. To get a better picture, the Exim policy should be viewed in conjecture with these measures. Important measures in this category include the following:

(i) Devaluation

The Rupee was devalued in July 1991 to make the exchange rate more realistic with a view to encouraging exports and discouraging imports.

(ii) Rupee Convertibility

The 1992-93 Budget introduced partial convertibility of the Rupee under the system known as Liberalised Exchange Rate Management System (LERMS). Under this, 60 per cent of the foreign exchange earnings under the current account could be converted at the free market rate quoted by authorised dealers. This was both a trade promotion and an economic liberalisation measure.

TABLE 1
CRITERIA FOR RECOGNITION OF EXPORT HOUSES AND TRADING HOUSES

	FOB Criterion		*NFE Criterion*	
Category	*Average FOB value of eligible exports made during the preceding three licensing years, in Rupees*	*FOB value of eligible exports made during the Preceding licensing year, in Rupees*	*Average net foreign exchange earned relating to eligible exports during the preceding three licensing years in Rupees*	*Net foreign exchange earned relating to eligible exports during the preceding licensing year in Rupees*
Export Houses	10 crores	15 crores	6 crores	12 crores
Trading Houses	50 crores	75 crores	30 crores	60 crores
Star Trading Houses	250 crores	300 crores	125 crores	150 crores
Super Star Trading Houses	750 crores	1000 crores	400 crores	600 crores

The 1993-94 Budget introduced the full convertibility of the Rupee on the trade account. Also see the section *the case of Indian Rupee* in Chapter 1.

Abolition of CCS and Exim Scrip

The Cash Compensatory Support (CCS) was a subsidy which the exporters of select items enjoyed. Export subsidies were subject to criticisms and retaliations abroad and it was a big burden on the exchequer. The CCS was abolished following the devaluation in 1991. As the devaluation increased the export profitability, it was felt that exporters would not be adversely affected by this measure.

The Exim Scrip (which was a modification of the earlier Replenishment (Rep) licence scheme) was abolished following the introduction of the partial convertibility. The Exim Scrip which was an import licence (which was freely tradable) for exporters was an incentive scheme because of the premium at which they could be sold in the open market by the exporters.

Import Duty Reductions

Over the last few years there have been very significant reductions in the import duties, leading to increasing exposure of the Indian economy to foreign competition.

Liberalisation of Foreign Investment

Another significant measures was the liberalisation of the foreign investment policy. This along with other economic policy liberalisations have been encouraging large flow of foreign investment.

AN EVALATION OF THE EXIM POLICY

The Exim policy and the associated measures of economic reforms or liberalisation have far reaching implications.

(i) The Indian economy has been exposed to more foreign competition. The regime of high protection is gradually vanishing. The tariff cuts and several other liberalisation measures are likely to continue in future. This means that the Indian firms should become competitive if they should survive. They have to pay due attention to cost and price, quality, delivery schedules, after sales service etc. In fact, a buyer's marketing is emerging in several industries which in the past were sellers' markets.

(ii) Another important implication of the liberalisation is that now Indian firms can obtain their raw materials and the like more competitively, including from abroad. This would help them to control costs and improve quality.

(iii) The liberalisation of capital goods imports will help reduce project and production costs and may encourage technological upgradation.

(iv) The increasing competition from abroad as well as from within is provoking many Indian firms to give an added thrust to exports. Some companies even view exports as a counter-competitive strategy.

(v) Because of the imports which they can make with their foreign exchange earnings several companies pay special attention to exports.

(vi) A very important implication of the exim policy is its intention to encourage the globalisation of India's foreign trade. One important objective of the current policy is to establish a framework for the globalisation of India's foreign trade. This has been given support by the fourth objective "to augment India's exports by facilitating access to raw materials, intermediates, components, consumables and capital goods from the international market". Indeed, facilitation of *global sourcing* is a prerequisite for globalisation of exports, for increasing the competitiveness of the exports and for globalisation of the business.

(vii) In the past, India followed an indiscriminate import substitution which was proved up by heavy protection. The lowering of the protection by import liberalisation is an open declaration that undue protection will not be granted any more. The shift to a pragmatic policy is indicated by the fifth objective of the Exim policy — "to promote efficient and internationally competitive import substitution and self-reliance under a deregulated frame work for foreign trade."

(viii) The progressive decanalisation implies more scope and freedom for private enterprise. The decanalisation seriously affects the business of state organisations like the State Trading Corporation of India (STC) and Minerals and Metals Trading Corporation of India. These corporations need to redefine the scope of their business and reorient their strategies for success in future. Indeed they have been doing that.

(ix) A commendable aspect of the current Exim policy is the importance given to elimination or minimisation of quantitative, licensing and other discretionary controls. However, we are yet to go a long way to procedural simplification.

(x) A drastic and welcome change in the attitude of the Government is reflected in the statement of objective of the new law, the *Foreign Trade (Development and Regulation) Act, 1992*, which has replaced the *Imports and Exports* (Control) Act, 1947. The objective of this Act is *to provide for the development and regulation of foreign trade by facilitating imports into, and augmenting exports from India and for matters connected therewith or incidental thereto.* Contrast this with the objective of the 1947 Act: *to prohibit or control imports and exports.* The objective of the new Act reflects a positive and dynamic attitude in contrast to the negative attitude of the old Act. However, the bureaucracy is yet to imbibe the spirit of the new attitude which is laid down in the paper.

Conclusion

In short, the Exim Policy 1992-97 acknowledges that trade can flourish in a regime of substantial freedom. It also recognises the need for reasonable stability of the policy, by making the duration of the policy 5 years.

The policy aims at simplification and transparency. It is, therefore endeavoured to make the procedures simple and easy to administer.

The new policy is quite in line with the economic reforms introduced in India. Due recognition of the need to give the Indian business a global orientation is a very important feature of the policy. In fact, this figures first in the list of the objectives of the policy.

The procedural simplification and minimisation of quantitative, licensing and other discretionary controls addressed to by the new policy are measures which were long overdue. A new culture, however, is yet to assure in.

In a nutshell, the implication of the new policy is that survival of a firm will depend on its competitiveness in the globalising environment and the competitive firms will have plentiful opportunities. The trends clearly suggest that the competitive exposures will increase. Indian firms will have to gear up themselves to survive and to become successful in the emerging borderless world.

ORGANISATIONAL SET-UP AND FUNCTIONS

The Organisational set-up to look after India's exports, as described in the Annual Report of the Department of Commerce, Ministry of Commerce, is given below:

Department of Commerce

The Department of Commerce in the Ministry of Commerce is responsible for the country's external trade and all matters connected with it such as commercial relations with other countries, state trading, export promotion measures, and the promotion, development or regulation of certain export oriented industries and commodities. The Department of Commerce formulates policies in the sphere of foreign trade, in particular the import and export of the country.

The Department of Commerce consists of eight principal functional divisions as mentioned below:

(i) Administrative and General Division;
(ii) Finance Division;
(iii) Trade Policy Division;
(iv) Foreign Trade Territorial Division;

(v) Export Products Division;
(vii) Export Industries Division; and
(viii) Export Service Division.

Autonomous Bodies

1. *Commodity Boards:* There are five statutory Commodity Boards responsible for production, development and export of tea, coffee, rubber, spices and tobacco.

2. *Export Inspection Council*: The Export Inspection Council, a statutory body, is responsible for the enforcement of quality control and compulsory preshipment inspection of various exportable commodities.

3. *Indian Institute of Foreign Trade.* The Indian Institute of Foreign Trade, registered under the Societies Registration Act, is engaged in the following activities:

(i) Training of personnel in modern techniques of international trade;
(ii) Organisation of Research in problems of foreign trade;
(iii) Organisation of marketing research, area surveys, commodity surveys and market surveys; and
(iv) Dissemination of information arising from its activities relating to research and market studies.

4. *Indian Institute of Packaging:* The Indian Institute of Packaging is registered under the Societies Registration Act. The main aims of the Institute are to undertake research on raw materials for the packaging industry, to organise training programmes on packaging technology, to stimulate consciousness of the need for good packaging, etc.

5. *Export Promotion Councils:* There are a number of Export Promotion Councils under the administrative control of Ministry of Commerce. These Councils are registered as non-profit organisations under the Companies Act. The Councils perform both advisory and executive functions. These Councils are also the registering authorities under the Import Policy for Registered Exporters.

6. *Federation of Indian Export Organisations:* The Federation of Indian Export Organisations is an apex body of various export promotion organisations and institutions. It also functions as a primary servicing agency to provide integrated assistance to Government recognised Export Houses and as a central coordinating agency in respect of export promotional efforts in the field of consultancy services in the country.

7. *Indian Council of Arbitration:* The Indian Council of Arbitration, set up under the Societies Registration Act, promotes arbitration as a means of settling commercial disputes and popularises arbitration among the traders, particularly those engaged in international trade.

8. *Marine Products Export Development Authority:* The Marine Products Export Development Authority, a statutory body, is responsible for development of the marine products industry will special reference to exports.

9. *Agricultural and Processed Food Products Export Development Authority (APEDA):* The Agricultural and Processed Food Products Export Development Authority was set up in 1986. The new Authority services as the focal point for agricultural exports, particularly the marketing processed foods in value added form.

10. *India Trade Promotion Organisation*: The ITPO was brought into being in 1992 by merging together the erstwhile Trade Fair Authority of India (TFAI) and the erstwhile Trade Development Authority of India (TDA). The functions of the ITPO are to:

(i) develop and promote exports, imports and upgrade technology through fairs in India and abroad;
(ii) compile and disseminate trade related information;
(iii) undertake publicity through the print and electronic media;
(iv) organise visit for foreign buyers and trade delegations to industry and trade establishment in India with a view to promoting trade contracts;
(v) assist Indian companies in trade development, organise export development programmes, buyer-seller meets, contact promotion programmes and integrated marketing promotion programmes for the trade industry in India.

11. *Public Sector Undertakings:* The following trading/service corporations are functioning under the administrative control of the Ministry of Commerce:

(i) The State Trading Corporation of India and its subsidiaries;
(ii) The Minerals and Metals Trading Corporation of India and its subsidiary, viz., Mica Trading Corporation;
(iii) The Spices Trading Corporation; and
(iv) The Export Credit Guarantee Corporation.

Advisory Body

Central Advisory Council on Trade: The Central Advisory Council on Trade, consisting of representatives from different organisations and individuals with business standing and expertise in the field of trade and commerce, advise Government on matters relating to:

(i) export and import policy programme;
(ii) operation of import and export trade controls;
(iii) organisation and development of commercial services; and
(iv) organisation and expansion of export production.

Attached and Subordinate Offices

1. *Office of the Director General of Foreign Trade :* The Import-Export Trade Control Organisation headed by the Director General of Foreign Trade

(DGFT) is responsible for the execution of the export and import policies of the Government.

The DGFT with the head office at New Delhi has subordinate offices located at Agartala, Ahmedabad, Amritsar, Bangalore, Bhopal, Bombay, Calcutta, Chandigarh, Cuttack, Cochin, Gauhati, Hyderabad, Jaipur, Kanpur, Madras, New Delhi, New Kandla, Panjim (Goa), Patna, Pondicherry, Rajkot, Shillong, Srinagar and Vishakhapatnam.

The Export Promotion Offices at Bombay, Calcutta, Madras, Cochin, Nagpur and Pune are also functioning under the administrative control of the Regional Joint or Deputy DGFT. In the past this office was called the office of the Chief Controller of Imports & Exports (CCIE).

2. *Directorate General or Commercial Intelligence and Statistics, Calcutta:* The Directorate is the primary Government agency for the collection, compilation and publication of the foreign, inland and ancillary trade statistics and dissemination of various types of commercial information. The Directorate brings out a number of publications, particularly on trade statistics which are utilised in framing economic policies, formulating trade agreements with foreign countries and monitoring these agreements. These publications are also used by the trading public and research scholars. The Directorate conducts studies on various topics relating to promotion of trade. It also helps in the settlement of commercial disputes and provides Indian businessmen going abroad with letters of introduction to Indian commercial representatives concerned. It maintains a Commercial Library which is widely used by the exporters, importers, research scholars and others.

3. *Office of the Development Commissioner*: For each Export processing zone, there is a Development Commissioner responsible for administration of the zone.

Export Promotion

Most countries have been taking deliberate measures to promote their exports due to various reasons.

When the domestic market is small, foreign market provides opportunities for achieve economies of scale and growth. Secondly, the supply of many commodities, as in the case of a number of agricultural products in India, is more than the domestic demand. Thirdly, exports enable certain countries to achieve export-led growth. Fourthly, export markets may help mitigate the effects of domestic recession. Fifthly, a country may need to boost its exports to earn enough foreign exchange to finance its imports and service its foreign debt.. It may be noted that many countries are suffering from trade deficit and foreign debt. Lastly, even in the case of countries with trade surplus, export promotion may be required to maintain its position, against the international competition and the level of domestic economic activity.

The main objectives of export promotion policy are to:

(i) compensate the exporters for the high domestic cost of production;

(ii) provide necessary assistance to the new and infant exporters to develop the export business;

(iii) increase the relative profitability of the export business vis-a-vis the domestic business.

The export promotion regime of India comprises incentives, facilities and assistance for export production, marketing assistance, financial assistance and institutional infrastructure.

Incentives

Export incentives are a widely employed strategy of export promotion. The main aim of these incentive is to increase the profitability of the export business.

Important export incentives in India include rebate of duties, cash compensatory support, income tax concession, interest subsidy, freight subsidy etc. It has been common to describe these as incentives. However, as the Abid Hussain Committee has observed, they are more a compensation for the comparative disadvantages faced by the Indian exporter than incentive. We give below a very brief account of these incentives which serve the first rational of export promotion mentioned earlier in this section, viz., to compensate the exporters for the high domestic costs.

Duty Exemption/Drawback

The scheme of duty exemption is designed to avoid the incidence of commodity taxes like excise duty customs duties on the exports so as to make the exports more price competitive. This is a world-wide practice and the rationale is straightforward. Customs duties and excise duties on inputs raise the cost of production in export industries and thereby affect the competitiveness of exports. Therefore, exporters need to be compensated for the escalation in their costs attributable to such customs and excise duties.

Duty exemption as an export promotion measure has its origin in India during the Second Plan. Over the years the scheme has been enlarged and modified.

The exporters are either exempted from the payment of duty while procuring inputs like raw materials and intermediates or, in cases where the duty is paid on the inputs, the duty paid is refunded. Thus, under the duty drawback system the exporters are reimbursed for the tariff paid on the imported raw materials and intermediates and central excise duties on domestically produced inputs which enter into export production.

Because of a series of modification to the import policy for registered exporters, particularly the introduction of the advance licensing system, exporters can now make most of the import of inputs without payment of customs duty. Eligible exporters are entitled to interest free bank credit against the duty drawback applicable to them upto a period of 90 days or upto the time they realise the drawback, whichever is earlier.

With the application of MODVAT, a large number of products, covered by the MODVAT, can be exported in bond and in that event the duty relief in the form of drawback would be restricted only to basic customs and auxiliary duties suffered, if any, by the inputs.

There are two types of drawback rates, viz., *all industry rate* applicable to a group of products and *brand rate* applicable to individual products not covered by the industry rate.

The all industry drawback rates are derived from estimates of average quantity of value of materials used in the manufacture of exports, the average amount of duties paid on imported materials or excisable materials used in the manufacture of these goods, and the average amount of duties paid on the materials wasted in the manufacturing process. Such average industry rates are fixed by the Drawback Directorate in the Ministry of Finance.

Cash Compensatory Support

One of the important benefits which the exporters in India enjoyed was a cash subsidy known as the cash compensatory support (CCS) for select export items. The CCS rates were different for different product groups. It varied from 5 to 20 per cent of the f.o.b. value subject to a maximum of 25 per cent of the value added. The CCS rates were determined after considering the incidence of unrebated indirect taxes (like the sales tax which was not reimbursed through the duty drawback scheme), the disadvantages implicit in higher freight rates and interest rates as compared with the competitors, and the cost of product/market development.

Thus, the CCS was a facility insofar as it sought to compensate for the unrebated indirect taxes and certain other disadvantages; and it was an assistance insofar as it attempted to provide resources for product/market development.

The CCS was abolished with the devaluation of the rupee in July 1991 and the introduction of the Exim Scrip.

Income Tax Concession

According to the income tax rebate provided to the exporters since the early 1960s, earnings from exports are either partially or fully exempted from income tax or taxed at a lower rate.

Awards

A number of awards have been instituted to encourage exports and to recognise excellence in exports. There are separate awards for different categories of exporters. Awards are given on the basis of certain specified criteria such as substantial increase in exports, successful introduction of new products, product development, successful breakthrough in foreign markets where conditions have been especially difficult etc.

REP/Exim Scrip

The Replenishment licence (REP) was a facility available to registered exporters to import specified items where the domestic substitutes were not adequate in terms of price, quality or availability. The REP licences which were related to the f.o.b. value of the exports were freely transferable and this enabled the exporters to sell the REP at a premium because of the great demand domestically for the items which could be imported under these licences. The trade policy announced on July 5, 1991 significantly modified the REP scheme and renamed it as Exim Scrip.

The Exim Scrip Scheme was abolished with the introduction of the partial convertibility of the Rupee by the Union Budget announced on February 29, 1992. According to the Liberalised Exchange Rate Management System (LERMS), 60 per cent of foreign exchange earnings by exports converted into rupees at the market determined rates. This increases the profitability of the export business when the market rate is higher than the official exchange rate.

IPRS

The International Price Reimbursement Scheme provides for the reimbursement to the exporter of the difference between the price of the domestically procured material and its international price in respect of materials like iron and steel. The IPRS has recently been replaced by EPRS.

An Evaluation of Export Incentives

An effective export promotion regime should compensate for the disadvantages of the national exporters and should make the export business profitable enough to lure entrepreneur to this sector and achieve the ultimate objective of boosting the exports.

The general feeling is that the export promotion regime in India has not succeeded in achieving these objectives. The Abid Hussain Committee has pointed out that:

1. The present regime of export promotion policies is mostly a compensation for disadvantages faced by the exporter on account of domestic economic policies, and the element of incentive, if any, is very small indeed.
2. The compensation is perhaps not entirely adequate whether we consider the CCS, the duty drawback system or the import facilities for export production.
3. Even if these factors were perfect in their operation, there is a wide range of factors that constrain export performance which are left untouched by the regime of export promotion policies.

Two studies about the export performance of companies financed by the ICICI have shown that export business is relatively unprofitable compared to the domestic business.

Financial Assistance

Financial assistance is given to the export sector mostly by the Export Import Bank of India and Commercial banks.

Commercial banks provide packing credit (pre-shipment credit) at concessional rates. They also provide post-shipment credit. Bank credit is also available against certain export incentives like duty drawback.

A very important development in the field of export financing was the establishment of the Export-Import (Exim) Bank of India in 1982. The Exim Bank extends financial assistance to Indian exporters through direct financial assistance, overseas investment finance, financial assistance to 100 per cent export-oriented units and units in export processing zones, pre-shipment credit, buyer's credit, lines of credit, relending facility, export bills rediscounting and refinance to commercial banks. Non-funded assistance in the form of guarantee is also extended by the Bank to Indian exporters.

Marketing Assistance

A number of steps have been taken to assist the exporters in their marketing effort. These include conducting, sponsoring or otherwise assisting market surveys and research; collection, storage and dissemination of marketing information; organising and facilitating participation in international trade fairs and exhibitions; credit and insurance facilities, release of foreign exchange for export marketing activities; assistance in export procedures; quality control and pre-shipment inspection, identifying markets and products with export potential; helping buyer-seller interaction; etc.

Market Development Assistance

An important export promotion measure taken by the Government was institution of the Market Development Assistance (MDA). Assistance under the MDA is available for market and commodity researches; export publicity and dissemination of information; trade delegations and study teams; participation in trade fairs and exhibitions; establishment of offices and branches in foreign countries; grants-in-aid to DPCs and other approved organisations for export promotion. Interest on Export Credit by commercial banks and approved co-operative banks enjoyed a subsidy, the MDA. Most of the MDA expenditure was absorbed by the CCS. The CCS helped the exporters to increase the price competitiveness of the Indian products in foreign markets.

Foreign Exchange

Foreign Exchange is released for undertaking approved market development activities, such as participation in trade fairs and exhibitions, foreign travel for export promotion, advertisement abroad, market research, procurement of samples and technical information from abroad etc.

Trade Fairs and Exhibitions

As trade fairs and exhibitions are effective media of promoting products, facilities are provided for enabling and encouraging participation of Indian exporters/manufacturers in such events. As mentioned earlier, foreign exchange is released for such purpose, the cost of participation is subsidised and the ITPO plays an important role in organising and facilitating participation in trade fairs/exhibitions. Besides the ITPO, some other promotional agencies also organise trade fairs. For example, the MPEDA organises seafoods trade fair, in India, in every 2nd year which attracts a number of foreign buyers and others connected with the seafoods industry.

Export Risk Insurance

As international business is fraught with different types of risks, measures have been to provide insurance covers against such risks. The Export Credit Guarantee Corporation (ECGC) has policies covering different political and commercial risks associated with export marketing, certain types of risks associated with overseas investments and risks arising out of exchange rate fluctuations. Further ECGC, extends the export credit risks cover to commercial banks. Marine insurance is provided by the General Insurance Corporation of India and its subsidiaries.

Quality Control and Pre-shipment Inspection

A number of steps have been taken by the Govt. to improve the quality of exports and to ensure that only goods of appropriate quality are exported from the country. The Export (Quality Control and Inspection) Act empowers the Government to make necessary regulations in this respect.

Institutional Assistance

As mentioned earlier, export marketing is assisted in different ways by a number of organisations like the ITPO, EPCs, Commodity Boards, Export Development Authorities like the MPEDA and APEDA, IIFT, Indian Missions Abroad, etc.

PRODUCTION ASSISTANCE/FACILITIES

Exports depend, inter alia, on exportable surplus and the quality and price of the goods. Government have, therefore, taken a number of measures to enlarge and strengthen the production base, to improve the productive efficiency and quality of products and to make the products more cost effective. Measures in these directions include making available raw materials and other inputs of required quality at reasonable prices, facilities to establish and expand productive capacity including import of capital goods and technology, facilities to modernise production facilities, provision of infrastructure for the growth of export-oriented industries etc. The important Government measures related to export production are the following:

EXPORT PROCESSING ZONES AND 100% EXPORT-ORIENTED UNITS

Export Processing Zones (EPZs) and 100 per cent Export-Oriented Units (EOQ) are two important schemes designed to promote competent industrial units which process goods exclusively for export markets. The salient features of these schemes which aim at enhancing the nation's export capability is the provision of necessary infrastructures and the facility for import of the required inputs, including capital goods and technology, without duty and other restrictions.

As the Tandon Committee points out, the phenomenon of Export Processing Zones is an extension of the earlier concept of Free Trade Zones (FTZs) where goods may be imported and processed for exports free of duty. Their main characteristic is that a country selects a specific area offering suitable air/sea and general infrastructural facilities, and extends certain important fiscal and other benefits on equal terms to both national and foreign entrepreneurs.

Capital goods, components, raw materials etc. required for export production are generally allowed to be imported to these zones duty free. Similarly, exports from these zones are duty free. In short, domestic rules, regulations, levies, taxes and general imports — federal, state or municipal whatever be their rationale for the domestic economy, are waived for the zone. The entrepreneur is, thus, given all freedom to import, process and export, subject of course to any basic social and legal constraints, such as the ecological, health etc.

The Kandla Free Trade Zone (KFTZ) started in 1965 is the first EPZ of India. The Kandla Free Trade Zone is indeed an EPZ and it is a misnomer to call it a free trade zone. A free trade zone, like a free port, is characterised by free imports to and exports from it. However, imports to the EPZ, though free, are subject to certain export obligation; the imports are allowed to facilitate exports. As the name implies an export processing zone is characterised by processing goods for exports. The exports from such zones are generally subject to the condition of value addition. An export from a free trade zone may even mean re-export of a good in the same condition as it was imported to the zone.

The KFTZ, located 10 kms away from the Kandla port, Gujarat, is a multiproduct zone established with the triple objective of promoting exports, generating more employment in the backward area of Kutch and fuller utilisation of the facilities provided by the Kandla port. The second EPZ of India, namely, the Santacruz Electronics Export Processing Zone (SEEPZ) was set up in 1974, 6 kms North of Santacruz Airport, Bombay, to take advantage of the international electronics boom which had attracted many similar zones in Asia. Four new zones have been established recently. They are: Falta Export Processing

Zone (W. Bengal), Madras Export Processing Zone (Tamil Nadu), NOIDA Export Processing Zone (Uttar Pradesh) and Cochin Export Processing Zone (Kerala).

The scheme of 100 per cent export-oriented units (EOUs) was introduced by the Government of India in 1980 as a measure to step up the growth of our exports in order to help bridge the trade gap.

The 100 per cent export-oriented unit is an industrial unit offering for export its entire production, excluding rejects or items otherwise specifically permitted to be supplied to the domestic tariff area (DTA). Such as unit would belong to an industry in respect of which the export potential and export targets have been considered by the relevant Export Promotion Council. The product concerned should not be subject to export control quota ceilings which can be used by existing units in the industry. The intention is that capacity should result in additionality to exports and not mere substitution.

Objectives

The major objectives of EPZs/EOUs schemes are the following:

(i) To augment exports and net foreign exchange earnings;

(ii) To facilitate transfer of technology;

(iii) To generate employment opportunities; and

(iv) To contribute to the overall economic development.

The Policy

The salient features of the Export-Import policy in respect of EPZs/EOUs are the following.

Eligibility

Units undertaking to export their entire production of goods may be set up under the Export Oriented Unit (EOU) Scheme or Export Processing Zone (EPZ) Scheme. Such units may be engaged in manufacture, production of software, agriculture, aquaculture, animal husbandry, floriculture, horticulture, pisciculture, viticulture, poultry and sericulture. Units engaged in service activities may also be considered on merits.

Existing DTA (domestic tariff area) units may also apply for conversion into an EOU but no concession in duties and taxes would be available under the scheme for plant, machinery and equipment already installed. Existing DTA units having an export obligation under the EPCG scheme may also apply for conversion into an EOU. On such a conversion, the export obligation under the EPCG scheme will be met concurrently from the exports by the unit as an EOU.

Benefits for EOUs/EPZ units

Concessional Rent: The units set up in the EPZs will be eligible for concessional rent for lease of industrial plots and standard design factory (SDF) buildings/sheds allotted for the first three years at the following rates:

For Plots: The concession will be 75% for the first year, 50% for the second year and 25% for the third year if production had commenced in the first year or the second year. The concession will not be available for the third year if production had not commenced by the end of the second year;

For SDF buildings/sheds: The concession will be 50% for the first year and 40% for the second year if production had commenced in the first year. The concession will be 25% for the third year if production had commenced in the first year. The concession will not be available if production had not commenced by the end of the first year.

Tax Holiday: EOUs and EPZ units will be exempted from payment of corporate income tax for a block of five years in the first eight years of operation.

FOB value of export of an EOU/EPZ unit can be clubbed with FOB value of export of its parent company in the DTA for the purpose of according Export House, Trading House, Star Trading House or Super Star Trading House status for the latter;

100% Foreign Equity: Foreign equity upto 100% is permissible in the case of EOUs and EPZ units.

The EOU/EPZ units will also be entitled for the same benefits, including grant of special import licence, as are available to the manufacturers who have acquired ISO 9000 (series) or BIS 14000 (series) or any other equivalent internationally recognised certificate of quality.

Importability and Leasing

An EOU/EPZ unit may import free of duty all types of goods, including capital goods, required by it for manufacture, production or processing provided they are not prohibited items in the Negative List of Imports. However import of Basmati paddy/brown rice shall be prohibited.

Second-hand capital goods may also be imported in accordance with the provisions contained in Chapter V.

An EQU/EPZ unit may, on the basis of a firm contract between the parties, source the capital goods from a domestic leasing company. In such a case, the EOU/EPZ unit and the domestic leasing company shall jointly file the import documents to enable import of the capital goods free of duty.

Approvals

Project applications satisfying the conditions mentioned in the appropriate Press Note of the Ministry of Industry may be given automatic approval within 15 days by the Development Commissioner of the EPZ concerned. In the case of EOUs, such approval shall be granted by the Secretariat of Industrial Approvals (SIA).

In other cases, approval may be granted by the Board (s) of Approval (BOA) set up for this purpose or Secretariat of Industrial Approvals, as the case may be.

DTA Sales

The entire production of EOU/EPZ units shall be exported subject to the following:

(a) Rejects upto 5% or such percentage as may be fixed by the Board of Approval may be sold in the Domestic Tariff Area (DTA), subject to payment of the applicable duties;

(b) 25% of the production in value terms may be sold in the DTA. DTA sale shall be subject to fulfilment of minimum value addition. No DTA sale shall be permissible in respect of jewellery, diamonds, precious and semi-precious stones/gems, motor cars, alcoholic liquors, silver bullion and such other items as may be stipulated by Director General of Foreign Trade by a Public Notice issued in this behalf.

(c) However, an EOU/EPZ unit in agriculture, aquaculture, animal husbandry, floriculture, horticulture, pisciculture, poultry and sericulture may, in accordance with the DTA sale guidelines notified in this behalf, sell upto 50% of the production in value terms in the DTA subject to fulfilment of minimum value addition.

(d) The electronics hardware products may be sold in the DTA on the following basis of the value addition norms specified by the Exim Policy.

The following DTA sales are counted towards fulfilment of export obligation:

(i) Supplies effected in the DTA which are eligible to be treated as 'deemed exports'.

(ii) Supplies effected in the DTA against payment in foreign exchange.

STATE TRADING

The Government's role in foreign trade is not confined to import and export controls, export promotion and import substitution measures. It directly participates in the import and export business through its agencies like the State Trading Corporation of India (STC), the Minerals and Metals Trading Corporation of India (MMTC), and the Mica Trading Corporation of India (MITCO) which have been set up by the Government of India to engage in import and export business in specified areas. In course of time, they came to account for more than one-fifth of India's foreign trade.

The State Trading Corporation of India Ltd. was established in 1956, primarily to deal with bilateral trading partners in East European countries.

The objectives of the STC, as envisaged by the Government, were:

(i) To help reduce the difficulties experienced in expanding trade with centrally planned countries;

(ii) To help maintain quantitative regulations of imports and some equilibrium in the prices of commodities and indigenous products;

(iii) To provide developmental finance for organised production and boost exports of small-scale sector;

(iv) To check unhealthy competition and undercutting of prices in international markets;

(v) To organise integrated development of production, transport and port facilitiesin rConcentration of Economic Power 283espect of bulk commodities;

(vi) To promote the production of non-traditional items and open up new fields for the export of traditional items;

(vii) To undertake internal trade as and when the situation warrants it;

(viii) To ensure adequate and regular supplies at reasonable and stable prices of essential commodities to meet local demand;

(ix) To effect exports and imports at more favourable prices through increased bargaining power;

(x) To stimulate the production of essential agricultural and industrial commodities by means of price and other incentives;

(xi) To facilitate the import of goods under foreign aid programmes;

(xii) To facilitate the implementation of trade agreements and barter deals; and

(xiii) To act as a vehicle for the implementation of Government policies.

Later, the STC was asked to pay due attention to the development of non-canalised exports and for the development of new products and markets for exports.

The STC has some subsidiaries (Projects and Equipments Corporation; Cashew Corporation of India; Handicrafts and Handlooms Exports Corporation of India and Central Cottage Industries Corporation).

The Minerals and Metals Trading Corporation of India Ltd. (MMTC) established in 1963 as a subsidiary of the STC was later made independent of the STC and further quite sometime later it was made a general trading house (instead of confining to minerals and metals trading).

Reorientation of the Role

Canalised trade has been the mainstay of the public sector trading houses. As pointed out earlier, with the new trade policy, the scope of canalisation has been substantially reduced. In this context the Government has clarified that the objectives of public sector trading organisations would be reoriented towards their emerging as international trading houses capable of operating in a competitive global environment, of serving as effective instruments of public policy and of providing adequate support to the small scale/cottage industries.

IMPORT SUBSTITUTION

Import substitution is regarded by many developing nations as an important means to reduce trade gap and to develop the economy.

Import substitution may be defined as the substitution of a domestic source of supply for a foreign source of supply.

It is clear from this definition that import substitution implies:

(i) The development or creation of new source of supply or productive capacity, if there is no domestic supply.

(ii) The expansion of the domestic production/supply, if the domestic supply is insufficient.

(iii) The protection of domestic industries against foreign competition, if the competitive disadvantage of the domestic industries, especially the infant ones, is encouraging the foreign source of supply.

Import substitution is one of the important planks of the commercial economic policy of developing countries. The foreign exchange scarcity created by the import-export gap has prompted these countries to lay emphasis on import substitution in a bid to reduce their import requirements and thereby to narrow or remove the trade deficit.

Import substitution has assumed importance in the Indian economic development policy since the Second Five-Year Plan. The large-scale imports necessitated by the development requirements of the nation gave rise to what may be called a development disequilibrium in the balance of payments. Export promotion and import substitution are the two important measures for narrowing down and ultimately wiping out the balance of payments deficit.

Industries and other sectors with a potential for import substitution have been given great importance in our development programmes. At the beginning of the planning era, India relied very heavily on foreign source of supply for the requirements of capital goods and a number of basic and other important inputs. In the last four decades, considerable import substitution has taken place in many important areas — in capital goods, cement, organic chemicals, pharmaceuticals, dye-stuffs, etc.

41

Five Years of Industrial Liberalisation

This chapter takes a quick look at the impact of liberalisation on the Indian industry.

Salient Features and Implications of Liberalisation

The liberalisation has tremendously expanded the scope of the private industry by removing many of the entry and growth restrictions. Prior to liberalisation, 17 of the most important industries were exclusively reserved for the public sector. Further, in 12 of the most important remaining industries the public sector was to play a dominant role. Even in the industries open to the private sector establishment of new units and expansion of the existing units were regulated by licensing. In addition to the industrial licensing, large companies and dominant undertakings had to obtain clearance under the Monopolies and Restrictive Trade Practices Act, (MRTP) Foreign companies were governed by the Foreign Exchange Regulation Act (FERA). Foreign investment was normally permitted only in priority industries, required prior approval of the Government and was normally subjected to a ceiling of 40 per cent of the total equity. Imports were restricted by very high rates of imports duty and other means.

These restrictive policies had resulted in slow growth of the industry and the economy and lack of competition causing lack of choice, high prices, poor quality, lack of innovation and disregard for the consumer.

The liberalisation has enormously expanded the scope of the private sector. Now only six industries are reserved for the public sector and even in some of these industries selective entry of the Private Sector is allowed. Industrial licensing is confined to 15 industries. These industries, subject to licensing, account for only 15 per cent of the value added in the manufacturing sector. The MRTP regulations pertaining to entry and growth were scrapped. In short, the private enterprises can now enter and grow in most of the industries. Further, automatic approval of foreign investment upto 51 per cent and foreign technology agreements are permitted for 35 priority industries. These industries account for about 50 per cent of the value added in the manufacturing sector.

As a result of this, investment has been surging, competition has been increasing, growth rate has been picking up, supply has been expanding in quantity and variety, industrial efficiency has been improving and exports growth has been accelerating. No wonder, the BJP and the National Front have proclaimed that they would not reverse the reform.

Increase in Investment

The liberalisation has given an enormous boost to private investment in the industrial sector. In 1990-91, the year prior to liberalisation, the total capital mobilised by the private corporate sector by equity issues was Rs. 1,261 crores. Assuming a debt equity ratio of 1.3, the total investment that would have taken place in the private corporate sector in that year would be less than Rs. 3,000 crores including the foreign capital. In 1994-95, i.e., within four years since liberalisation the equity capital moblised increased to about Rs. 27, 621 crores. Including the foreign capital, the total investment could be over Rs. 65,000 crores. In the 1970s, the average annual amount of capital raised by the corporate sector from the primary market was below Rs. 100 crores. In 1995, a single organisation (IDBI) had an issue of over Rs. 2,000 crores which was over-subscribed.

The expansion plans of many Indian corporates, both in the Public and Private sectors, are impressive indeed. The public sector giant SAIL which has been performing fairly well for some time now has massive investment plan. The public sector HPCL plans an investment of Rs. 20,000 crores over the next five years. The IPCL is carrying out an expansion plan of Rs. 5,000 crores. The Nagarjuna group plans an investment of Rs. 100 crores in the next five years. The Jindal Strips would be investing about Rs. 2,000 crores. The Nalco, which is Asia's largest aluminium company, is planning an additional investment of Rs. 2,450 crores. The Murugappa groups has a plan to invest Rs. 700 crores. Three Tata Companies, TISCO, Telco and Tata Power, have drawn up plans to raise Rs. 20,000 crores over the next four years to fund huge expansion plans. These are but some examples which indicate the spurt in investment taking place under the impetus of liberalisation. The massiveness of the size of the investment plans of the companies or conglomerates becomes more obvious when they are compared with the total investment in the industrial sector in the past. The proposed public sector investment on industry during the First Five Year Plan was only Rs. 173 crores. The overall fixed investment, both the public and private sectors taken together, during the Second Five Year Plan (1956-61) was only Rs. 1,620 crores.

The number of industrial entrepreneurs memorandum (IEM) and letters of intent (LOI) filed increased from 3,279 with a proposed investment of Rs. 78,381 crores and employment of about 8 lakhs of people in 1991 to 5,210 with proposed investment of Rs. 1,06,708 crores and employment of about 9.6 lakh people in 1994.

See table

Table 1

Industrial Investment Intention Through IEMs Filed and LOIs

Year	*Numbers*	*Proposed Investment (Rs. crore)*	*Proposed Employment ('000)*
1991	3,279	78,381	803
1992	5,480	1,29,866	1020
1993	4,984	76,871	804
1994	5,210	1,06,708	959
1995 (Jan. - Oct.)	5,714	1,21,029	1010
Total	24,667	5,05,290	4596

Priority sectors have been receiving massive investments since liberalisation. Over 80 per cent of the surging foreign investments, for example, has been in the priority sectors/industries, including power generation.

Increase in Turnover

The turnover of many companies is witnessing a high-jumb. The turnover of the Reliance was projected to more than double from Rs. 5,300 crores to Rs. 12,000 crores in a short span of 3 to 4 years. The Murugappa group's turnover is estimated to double from about Rs. 2,500 crores in 1995 to Rs. 5,000 crores by the turn of the century and of the Modern group to more than double from Rs. 525 crores to Rs. 1,135 crores in two years. The Kirlosker group's turnover is projected to leapfrog from Rs. 1,300 crores to Rs. 7,000 crores by 2,000. Ranbaxy's sales may increase from over Rs. 700 in 1995 to about Rs. 3,200 crores by 2,000.

Many industries will witness unprecedented and manifold output growth in the near future. For example between 1995 and 2,000, the production of motor cars is estimated to increase from 2.6 million to about 6.5 million, of colour television sets from less than 2 million to about 11 million (4 million of which is expected to be exported) and of refrigerators from 1.8 million to 4.5 million.

One may argue that several of the industries which are witnessing output spurt are luxurious and therefore the common man does not benefit. No one can belittle the need for emphasis on the priority needs in a country with a vast poor people. However, the employment and other beneficial effects of the enormous growth of even the luxurious industries cannot be ignored. Think of the substantial employment generation that can result in the service sector related to the above industries as in the repair/service shop etc. in addition to the direct and indirect employment generation in the manufacturing sector. Further, the government can mop up significant amount of tax revenue which will enhance the Government's ability to devolve more resources for the welfare of the poor.

It will take some time for the new investments to get fully reflected in the industrial growth rate. Acceleration of the industrial growth rate, however, is already visible. After near stagnation for two years, the industry grew by about 8.6 per cent in 1994-95 and is expected to show up 12 per cent in 1995-96. A very impressive aspect is that during 1994-95 the capital goods industry produced an output growth of a magnificent 25 per cent. In 1995-96 it is estimated as about 14 per cent which also is impressive, coming on top of the very high rate of the previous year. Added to this is the large import of capital goods. This spurt in the demand for capital goods is an indication of the brisk industrial activity and expansion of the productive capacity of the industry. About Rs. 10,000 crores worth of capital goods were reported to have imported last year under the Export Promotion capital Goods Scheme which implies that within the next five years additional exports worth about Rs. 40,000 crores will be generated out of these imported capital goods.

Improving Competitiveness and Internationalisation

Some of the performance indicators suggest that under liberalisation the Indian industry has strengthened itself and has become more competitive, contrary to the fear that the liberalisation and the resultant foreign competition would weaken and even strangle down the Indian Industry. Indian companies could substantially increase their sales and profits in the last few years. The increase in competition is reflected in the increase in marketing costs and fall in profitability; but total profits have been up because of higher sales.

Another indication of the strengthening competitiveness of the Indian companies is the rise in their export intensity (i.e., the ratio of exports to total sales). The estimates of export intensity show that it has moved up to 11 per cent in 1994-95 from less than 8 per cent four years ago.

The export GDP ratio (i.e., the ratio of the value of exports of GDP) shows a corresponding, reinforcing trend. The export-GDP ratio normally rises when an economy develops. For nearly four decades since the commencement of planing, India presented a very peculiar case of the export-GDP ratio remaining more or less stagnant at a very low level (even in comparison with other developing countries) of 5 to 6 per cent. The liberalisation has, however, pulled up this ratio from the long held trap. It was about 9 per cent in 1994-95.

The growth impulses provided by the liberalisation, increasing competition in the domestic market and growing business opportunities abroad are encouraging many Indian companies to enter foreign markets/expand foreign business. A number of them have established wholly owned subsidiaries or joint ventures abroad. Indian companies have also taken over a number companies in the foreign countries. Several Indian firms have entered into licensing agreements and strategic alliances to foster business abroad.

Foreign Investment

A substantial step up in the investment is required to accelerate the growth rate of the Indian economy. As domestic savings has its own limitations in achieving this, foreign investment assumes importance. In 1994-95, India's savings rate, which was an all time high, was only 24.4 per cent of the GDP.

The liberalisation had the effect of boosting foreign direct investment (FDI) in India. The total FDI in India during the entire decade of the 1980s was less than $ 1 billion. It shot up from about $ 0.3 billion in 1991 to about $ 1 billion in 1994 and $ 2 billion in 1995. Yet FDI accounted for just 2.1 per cent of India's gross domestic investment last year compared with the 20 plus per cent share of FDI in China's gross domestic investment. In 1994-95, according to quick estimates, FDI was less than 0.4 per cent of India's GDP. In 1995-96, it could be near one per cent. Given the incremental capital-output ratio of 4.1, and FDI investment of one per cent of GDP will add only about 0.2 per cent to the economy's growth rate. According to the estimates of *Business Today*, if India has to manage a GDP growth rate of over 8 per cent over the next two years — assuming a savings rate of 25 per cent of GDP-FDI inflow of over 6 per cent of the GDP will be required. It may be noted that China has been able to maintain a GDP growth rate of over 8 per cent for a long time because of a high savings rate (40 per cent of GDP) and huge inflow of FDI (about 20 per cent of the domestic investment). Only about one-fifth of the FDIs cleared by the Government of India has materialised. For instance, the clearances amounted to about $ 4.5 billion in 1994 and $ 10 billion in 1995. In comparison with countries like China, foreign investors find the Indian policy and procedural system perplexing and time consuming.

Lage FDI inflows are required for the development of certain sectors. For example, the Central Electricity Authority has forecast an additional generation capacity of 57,000 MW during the Ninth Plan (1997-2002) as the requirement for meeting the demand for power which is expected to grow at the rate of 9 per cent per year. The investment that the additional capacity of will call for has been projected at $ 47 billion (i.e., about Rs. 1,64,500 crores) for the private sector alone for putting up an additional capacity of 37,000 MW (assuming that the public sector will add 20,000 MW). It may be noted that the election manifesto of even the CPM has acknowledged the role of FDI in areas of national priority.

The portfolio investment has also been showing an impressive growth. The number of FIIs registered with the SEBI increased from 10 with a cumulative investment of $ 0.2 million in January 1993 to 331 with a cumulative investment of $ 5.5 billion in April 1996.

Need for Proper Orientation

The reform process is yet to become sufficiently clear, particularly in the implementation aspect. The bureaucratic attitude does not appear to have sufficiently reoriented to carry forward the reform process in the real earnest. This is a crucial task to be addressed by the present government.

One very serious problem which many firms in India are facing is the excess manpower employed by them. To improve productivity they have to get rid of this surplus which in many cases is an alarmingly large number. This indicates that for the liberalisation to be successful, the economy should grow very fast to absorb this surplus displaced and the new entrants to the job market (including the existing stock of the unemployed).

An alarming development under liberalisation is the unscrupulous way the Government has been implementing the policy as well as the foreign companies have been behaving. The Government policy would have given the public an impression that even in the priority industries foreign equity participation would be limited to 51 per cent. However, a number of foreign companies, after having jacked up their equity holding in the Indian subsidiaries for a song, through preferential issues, to 51 per cent, are setting up new fully owned subsidiaries to do businesses which their existing subsidiaries could do. Most of these are in the non-priority areas. This is a covert deception by the Government — multinational collusion using the saving clauses and exceptions of the policy. This could cause large foreign exchange outgo by way of dividend repatriation. Foreign investment should be discouraged in non-priority areas.

The growing competition calls upon the Indian firms to devote more attention to R&D and to build up their own capabilities and competancies to survive and grow.

The business environment in India has undergone a radical change. The Indian industry is responding to it remarkably well despite the drawbacks of the past protracted protection, the shock of sudden liberalisation, absence of a clear and favourable exit policy and environment, and several other odds in comparison with the foreign counterparts. The situation could be further improved by making the reform more pragmatic based on the lessons of the experiences.

ANNEXURE

ECONOMIC POLICY OF UF GOVERNMENT

The general economic policy of the United Front Government headed by H.D. Dave Gowda, expressed through its *Common Minimum Programme (CMP)*, is, in fact, an extension of the economic policy pursued by the Narasimha Rao Government, with some fine-tunings. The salient features of its are given below.

Stimulation of Industrial Sector

The United Front, which recognises that the key to faster economic growth is rapid labourintensive industrialisation, is committed to maintain a 12 per cent annual growth in the industrial sector. This will require the continuation of the process of deregulation and decontrol and massive capital investment and modern technology.

Special plans will be devised to promote small and cottage industries to achieve the turn objectives of growth and employment.

Industrialisation of backward areas is proposed to be promoted by devising suitable incentive schemes.

Public Sector Policy

The CMP which proclaims that the public sector will continue to be an important component of Indian industry and that the Government will help make the public sector strong and competitive, makes it also clear that in a competitive and technology driven economy, there is no room for monopolies and inefficiency. Public sector enterprises which are essentially commercial enterprises should conduct their business on commercial lines and should show a healthy return on capital employed. Government will support public sector companies that have comparative advantage in their drive to become global giants. The CMP also points out the need for reform and restructuring of the public sector and professionalisation of management.

Sick or potentially sick public sector companies will be rehabilitated through a menu of options that may include handing over the management to professional groups of workers' co-operatives.

The policy decision of the previous government of the public sector withdrawing with from non-core and non-strategic areas is not denounced by the CMP. It has proposed a Disinvestment Commission to advise the government.

Foreign Investment

The CMP which emphasises the need to stimulate domestic savings and capital formation recognises that "at the margin, the country cannot do without foreign investment, particularly if that foreign investment will also bring modern technology and management practices and create new markets for products manufactured in the country. The nation needs and has the capacity to absorb at least $10 billions a year as foreign direct investment." The Government is to rely on suitable fiscal and monetary measures to channelise the bulk of the new investments, both domestic and foreign into the core and infrastructure sectors and to discourage the entry of the multinationals into low priority areas.

Further Deregulation

It is clear that the UF government is wedded to carry further forward the process of deregulation ushered is by the Narasimha Rao Government. For example referring to the agricultural development policy, the CMP states that all controls and regulations that are in the way of increasing the incomes of farmers will be reviewed immediately and abolished wherever found unnecessary. Controls on movement of agricultural products will be abolished.

Indicating a fine-tuning of the industrial policy, envisaged in the CMP, the industry minister Murasoli Maran stated that the government would be pruning the industrial licensing list further.

It is also significant to note the importance accorded by the CMP to transparency.

An Evaluation

The economic policy of the United Front Government, which consists of and supported by political parties many of which were strong opponents of the economic liberalisation of the Narasimha Rao government, is in fact a reinforcement and continuation of the old policy. The economic policy announcements of the 13 days long BJP government also amounted to the same. Thus, India's economic liberalisation is now almost unanimously accepted by all parties, including the communists; it has come to stay. Whichever political party or combine comes to power in future, the difference will be, at the most, in its fine-tuning. In other words the major differences between the political parties in India will no more be related to economic policies or ideologies; the differences will pertain rather to ethic and related factors (including the issue of secularism) and regional factors.

It is very interesting to note that the U. F. government, made up of and supported by some political parties which were staunch critics of opening up of the Indian economy to multinationals and foreign investment, cries for an annual foreign direct investment of at least $ 10 billions compared to about $ 2 billion achieved in 1995. The UF government's policy is very soft even in respect of multinationals in low priority areas. The CMP contemplates only to discourage (not to ban) the entry of multinationals into low priority areas through fiscal and other measures.

A major obstacle to the fast development of the economy has been the infrastructural bottlenecks. As the CMP rightly observes, the economy cannot grow and the needs of the people cannot be met without more capacity in power oil, telecom, railways, roads and ports. It is heartening to note that the UF government stipulates a stepping up of the investment in infrastructure from the present 3.5 — 4 per cent of GDP to at least 6 per cent in the next few years. The cumulative requirement of the infrastructure sectors over the next five years is estimated to be $ 200 billion (Rs. 700,000 crores) at the very minimum. The CMP which acknowledges the role of foreign investment in this context, proposes a review of the scope, functions and the procedures of the Foreign Investment Board in order to make it an effective and credible instrument to foreign investment in India. What a change from the pre-1991 regime of not allowing even the domestic private capital in most of the vital infrastructure (the price of which now the nation is paying by inadequacies, inefficiencies and high costs).

The import duty levels in India were among the highest in the world. The protective customs tariffs were steadily reduced from a peak rate of over 300 per cent in 1991 to 50 per cent in 1995. Many constituent parties of the UF and its supporters were strongly opposed to the import liberalisation. But, interestingly enough, the UF government is committed to further reduction in the import duty. The CMP states that the progress towards the goal of bringing India's tariffs in accord with world levels will be measured and caliberated and that an independent Tariff Commission will be appointed to hear and determine tariff disputes as well as to recommend appropriate levels of tariffs for different products and different industries keeping in views the larger interests of the country.

The CMP says that a new law will be made to deal with industrial sickness which will also provide for a separate mechanism to deal with sickness in small industries. Although it is generally acknowledged that the Sick Industrial Companies (Special Provisions), Act, 1986, is not effective enough, the CMP does not indicate. What is wrong with the present law and how the new law will be different from the present one. The proposal for a separate mechanism in the law to deal with sickness in the small scale sector may appear to be good. However, what will be the nature of this mechanism and how effective it will be are to be seen.

As was the case with the Narasimha Rao government, the UF government also emphasises the need for better fiscal management and price stability.

One of the important criticism against the economic liberalisation was that it would widen the disparities in income distribution and would make life harder for the lowest strata. The economic policy of the UF government has no concrete proposal regarding improving the income distribution. There was a feeling that since the beginning of the 1970s, the emphasis given on growth with social justice had the effect of sacrificing growth. The economic liberalisation was criticised that it was over emphasising growth at the expense of social justice. The CMP, which visualises that the country's GDP needs to grow at over 7 per cent annually in the next 10 years in order to abolish endemic poverty and unemployment, clearly states that there is no substitute for growth. At the same time it proclaims that growth with social justice will be the UF government's motto. The usual measures such as remunerative prices for farmers, improved public distribution system and price stability, housing programmes for the poor etc. are proposed. Protection of worker's interests are also mentioned in several contexts in the CMP.

The export sector and foreign investment by Indian companies have assumed more importance today because of the liberalisation in India and all around the world. The economic policy of the UF government contained in the CMP seems to have ignored them.

To put it in one sentence, the economic policy of the UF government is the same old wine in the same old bottle.

OUR OUTSTANDING PUBLICATIONS IN COMMERCE AND MANAGEMENT

Acharya & Govekar	**Business Policy and Administration**
Aswathappa, K.	**Essentials of Business Environment**
Cherunilam, Francis	**Business Environment**
Cherunilam, Francis	**Business and Government**
Srivastava, R.M.	**International Strategic Management**
Bansal, C.L.	**Business and Economic Laws**
Parulekar, N.W.	**Model Mannual on Labour Laws**
Balagopal, T.A.S.	**Export Management**
Avadhani, V.A.	**Investment and Securities Markets in India -- Investment Management**
Balasubramanium, N.	**Corporate Financial Policies and Shareholders Returns**
Chopra, R.K.	**Office Management**
Ghosh, Biswanath	**A New Look -- Organisational Behaviour**
Ghosh, S.K.	**Service Conditions of Central Government Servants (Including Railway Employees)**
Michael, V.P.	**Perspective Management**
Acharya, Govekar & Others	**Field Sales Management**
Chunawalla & Sethia	**Foundations of Advertising -- Theory and Practice**
Chunawalla & Others	**Advertising Theory and Practice**
Mishra, M.N.	**Sales Promotion and Advertising Management**
Sahoo & Sinha	**Services Marketing: Text & Readings**
Chunawalla & Patel	**Production and Operation Management**
Krishnaswami, O.R.	**Methodology of Research Social Sciences**
Rayudu, C.S.	**Media and Communication Management**
Ratnam & Raju	**Budgeting**
Anand, K.	**Networking Concepts & Netware**
Kulkarni, P.V.	**Financial Management**
Reddy & Appannaiah	**Financial Management**
Satyanaraya, Sarma & Ramamurthy	**Lease Financing in India**
Srivastava, R.M.	**Essentials of Business Finance**
Srivastava, R.M.	**Management of Indian Financial Institutions**
Singh, Preeti	**Investment Management**
Aswathappa, K.	**Organisational Behaviour**
Chakraborty, S.K.	**Foundations of Managerial Work -- Contribution from Indian Thought**
Chopra, R.K.	**Office Organisation and Management**
Gupta, N.S.	**Organisation: Theory and Behaviour**
Mercy Anselm	**Organisational Behaviour**

ISBN 81-7493-249-6

Rs. 135